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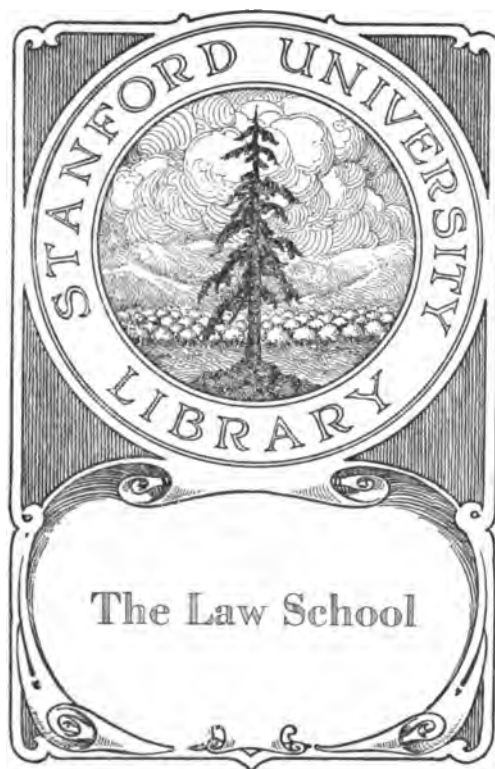
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BUSINESS LAW

A Working Manual of Every-day Law

By

THOMAS CONYNGTON

Of the New York Bar; Author of "Corporate Organization
and Management," "The Modern Corporation," etc.

VOLUME I



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PREFACE

Law and order are the necessary foundations for civilized life. A pastoral people with few possessions needs few and simple laws. A populous, modern state with complex social, industrial, and commercial relations requires intricate and far-reaching regulations. In this country the latter condition prevails, and our present legal system has not kept pace with our perhaps too rapid progress in other ways.

Our system of laws is an inheritance from our Anglo-Saxon ancestors, supplemented by written constitutions and multitudinous legislative enactments. Much of our law is judge-made. Like our forebears, we revere precedents and decisions and have more of this kind of law than we know how to use. We have our federal courts and forty-eight separate state systems, all grinding out innumerable volumes of reports. In consequence, this source of law has become cumbersome and somewhat unmanageable. Beyond this we are subject to the Constitution of the United States with its eighteen amendments, as well as the constitutions of our individual states; to the enactments of Congress and to those of our state legislatures; to the ordinances of boards of aldermen; to the regulations of boards of health and education; and to the orders of many other boards, bureaus, commissions, and officials. With the multiplicity of regulation that all this entails, it requires no small amount of care and study to avoid unwitting entanglement in the far-extended meshes of the law.

Yet from this unwieldy mass of law may be elicited certain guiding principles that everyone should know—general rules that will guide us safely past most of the difficult places.

Knowing these, it is possible for a man so to shape his business course and his relations with his fellows as to have little to do with courts or lawyers. Courts and lawyers are necessary institutions—so are doctors and hospitals—but all of us prefer to avoid both so far as possible and so long as possible.

It is the admirable theory of the law to secure right and justice to all men. The practical application of the law through the courts, however, does not always attain these ends. Some reasons for this are set forth in the following pages. Also suggestions are given as to how one may shape his conduct and manage his affairs in order to avoid the more serious legal difficulties. The man or woman who owns property, who does business and engages in affairs, should know the principles upon which our law is based, should know how to apply these principles to the more usual happenings, and should know when and how to employ "counsel learned in the law." The advice here given is, as near as may be, such as would be given by a conscientious lawyer who desired to keep his clients out of the courts, rather than to win cases. All men should know some law, and it is devoutly to be hoped that the day will come when even those who write romances and photo-plays will know enough law to avoid the preposterous legal situations that cause so much trouble to their heroes and heroines.

To adapt the book better to the needs of those intending to become professional accountants, the C.P.A. examinations of the various states for the past five years have been examined and, where necessary, the text has been expanded to cover all the more important questions. Many of the questions given in these examinations refer purely to local statutes, and answers must be found in the laws of the state in which the examination is held. In such cases the fact has been indicated. Other questions, outside the scope of this work, are apparently brought in by the examiners for the purpose of keeping quali-

PREFACE

v

fied students from receiving the C.P.A. degree. This seems a hard thing to say but *The Journal of Accountancy* for October, 1919, expresses editorially the same opinion:

Apparently some state boards in the past have been chiefly concerned with an effort to convince the public of their innate cleverness. They have presented questions which it would be ridiculous to expect a candidate to answer without reference to authorities, and as a result they have excluded many men fully qualified to practice as public accountants. Out of this condition has grown the quite frequent allegation that accountants are trying to build up a close corporation by preventing newcomers.

To assist students of business law, questions have been appended to each chapter. Some of these have been taken from C.P.A. examinations, some are intended to provoke inquiry rather than direct answers, and others are the usual type of review questions.

The author desires to acknowledge his indebtedness to Elizabeth A. Smart of the New York Bar for her valued collaboration on the first edition of this work; to W. J. Grange, of the New York Bar, for careful reading and helpful comment; to P. W. Pinkerton, of Indianapolis, for his many excellent suggestions and improvements in the text; to James H. Wilhoit, of the New York Bar, for assistance in preparing the chapter on bills of exchange; and to Katharine S. Keane, for careful and intelligent research in connection with the preparation of this edition and for good work in the compilation of the index.

The author desires also to extend his thanks to, and testify his appreciation of, all those interested readers throughout the country who by their questions and comments on the original text have enabled him to make the present edition more accurate and comprehensive than would otherwise have

been possible. He bespeaks for the present volumes a continuance of their kindly interest.

Blackstone has said in his famous Commentaries that "the science of the law should in some manner be the study of every free citizen." If this work can make plain to its readers some of the practical features of the law under which we live, so that they may appreciate its virtues and know its faults, and from that knowledge may, by their influence and votes, strive to simplify its procedure and remedy its deficiencies, the book will have served its end.

THOMAS CONYNGTON

New York City,
March 1, 1920.

CONTENTS

VOLUME I

Part I—The Law of the Land

CHAPTER	PAGE
I EVOLUTION OF LAW	3
§ 1. Definition	
2. The Origin of Law	
3. Law and Liberty	
4. Sources of Law	
II THE WRITTEN LAW	7
§ 5. Definition	
6. Constitutional Government	
7. The United States Constitution	
8. Laws of Congress	
9. State Constitutions	
10. Constitutional Amendments	
11. Constitutions that Legislate	
12. Legislative Enactments	
13. Statute Law	
14. Subsidiary Laws	
III THE UNWRITTEN LAW	15
§ 15. Definition	
16. The Doctrine of Precedents	
17. Court Reports	
18. The Volumes of Reports	
19. Citations	
20. The Common Law	
21. Law-Merchant and Commercial Law	
22. Unconstitutional Laws	
23. The Recall of Judges	
IV LAW AND EQUITY	22
§ 24. Remedial Law	
25. Equity in the Legal Sense	
26. Suits at Law and in Equity	
27. Bringing a Suit at Law	
28. Trial at Law	
29. Bringing a Suit in Equity	
30. Appeals to a Higher Court	
31. Advisability of Litigation	
V CRIMINAL LAW	35
§ 32. Criminal Procedure	
33. Classes of Offenses Against the Criminal Law	
34. Penalties	

Part II—Contracts

CHAPTER	PAGE
VI ESSENTIAL FEATURES OF A CONTRACT	41
§ 35. Introductory	
36. Definition	
37. Essential Features	
38. Competency of Parties	
39. The Subject Matter Must be Lawful	
40. The Law of Place	
41. The Subject Matter Must Exist	
42. Agreement of the Parties	
43. Oral Agreement	
44. Consideration	
VII HOW CONTRACTS ARE MADE	56
§ 45. Classification of Contracts	
46. Oral Contracts	
47. Written Contracts	
48. The Statute of Frauds	
49. Contracts Under Seal	
50. Contracts of Record	
51. Express and Implied Contracts	
52. Quasi Contracts	
53. Executory and Executed Contracts	
54. Conditions Precedent and Subsequent	
55. Void and Voidable Contracts	
56. Drafting a Contract	
VIII EFFECT OF CONTRACTS	68
§ 57. Illegal Contracts	
58. Effect of Mistakes	
59. Effect of Fraud	
60. Duress	
61. Undue Influence	
62. Law as to Alteration	
63. Interpretation of Contracts	
IX ASSIGNMENT AND NOVATION	79
§ 64. Assignment of Contracts	
65. Novation	
X DISCHARGE OF CONTRACTS	84
§ 66. Discharge by Performance	
67. Discharge by Agreement	
68. Discharge by Various Other Causes	
XI ENFORCEMENT OF CONTRACTS	92
§ 69. Breach of Contract	
70. Remedies for Breach of Contract	
71. Law Governing Remedy	
72. Statute of Limitations	

CONTENTS

ix

CHAPTER	PAGE
XII ACTIONS ON CONTRACTS—GENERAL RULES	103
§ 73. Introductory	
74. Specific Performance	
75. Rules of Evidence	
XIII TENDER OF PAYMENT OR PERFORMANCE	111
§ 76. Definition	
77. Time to Tender Performance	
78. Extent and Kind of Tender.	
79. Acceptance of Tender	
XIV JOINT AND SEVERAL CONTRACTS	115
§ 80. Contracts Made by More Than Two Parties	

Part III—Sales

XV CONTRACTS TO SELL	121
§ 81. Sales and Contracts to Sell	
82. Uniform Sales Act	
83. What is Necessary to the Contract of Sale	
84. The Agreement	
85. Sales to Persons Incompetent to Contract	
86. The Consideration	
87. Nature of Subject Matter	
88. Destruction of Subject Matter	
89. Sales to Arrive	
90. A Contract of Sale Must Be Legal	
XVI PASSING TITLE	129
§ 91. Delivery	
92. Selection Necessary to Delivery	
93. When the Title Passes	
94. Sales Without Delivery	
95. Conditional Sales	
96. State Laws on Conditional Sales	
97. Requirement of Affidavits to Conditional Sales Contracts	
98. Rights in Illinois and Pennsylvania	
99. Protection Against Landlord's Lien	
100. Protection Against Destruction of Property	
XVII THE STATUTE OF FRAUDS	138
§ 101. Description of the Statute of Frauds	
102. Contracts to Sell	
103. When the Contract of Sale Must be in Writing	
104. Exception for Part Payment	
105. Exception for Part Delivery	
106. Exception for Amounts Below Specified Value	
107. Exception for Work or Services	

CHAPTER	PAGE
XVIII WARRANTIES	144
§ 108. Introductory	
109. Conditions Precedent	
110. Conditions Subsequent	
111. Express Warranties	
112. Implied Warranties	
XIX REMEDIES	151
§ 113. Rights of Unpaid Seller Under the Contract	
114. Rights of Buyer	
115. Rescission of Sale	
XX SALES AT AUCTION	159
§ 116. Regulations for Sales at Auction	
117. Compliance with Conditions	
118. Duties of Auctioneer	

Part IV—Agency

XXI PRINCIPLES OF AGENCY	165
§ 119. Introductory	
120. Definitions	
121. The Principal	
122. The Agent	
123. General Agents	
124. Special Agents	
125. Del Credere Agents	
XXII THE CONTRACT OF AGENCY	173
§ 126. Appointment	
127. Express Appointment	
128. Implied Appointment	
129. Ratification	
130. Sealed Contracts	
131. Appointment of Subagents	
132. Servants and Employees	
133. Void Contracts of Agency	
XXIII THE PRINCIPAL	182
§ 134. Principal's Duty to Agent	
135. Principal's Duty to Third Party	
136. Principal's Liability	
137. An Undisclosed Principal	
XXIV THE AGENT	188
§ 138. Agent's Duty to Principal	
139. Agent's Obedience	
140. Agent's Good Faith	
141. Agent's Care, Skill, and Diligence	
142. The Agent's Signature	

CONTENTS

xi

CHAPTER		PAGE
	§ 143. Agent's Duty to Third Party	
	144. Limitation of Agent's Authority	
	145. Agent's Fraudulent Conduct	
	146. Agent's Liability	
XXV	THE THIRD PARTY	202
	§ 147. Third Party's Relation to Agent	
	148. Third Party's Relation to the Principal	
XXVI	TERMINATION OF AGENCY	205
	§ 149. Termination by Fulfilment	
	150. Termination by Either Party	
	151. Termination by Disability	
	152. An Agent with an Interest	
 Part V—Negotiable Instruments		
XXVII	FORM AND INTERPRETATION	213
	§ 153. The Quality of Negotiability	
	154. Signature	
	155. Unconditional Promise	
	156. Certainty as to Sum	
	157. Payable on Demand	
	158. Certain Future Time	
	159. Payable to Order	
	160. Payable to Bearer	
	161. The Date	
	162. Consideration	
	163. Delivery	
	164. Rules of Construction	
	165. Allowable Provisions	
	166. Non-Essentials	
XXVIII	NEGOTIATION	222
	§ 167. Method of Negotiation	
	168. The Indorser's Contract	
	169. Blank or Special Indorsement	
	170. Restrictive Indorsement	
	171. Qualified Indorsement	
	172. Conditional Indorsement	
	173. Effect of Indorsement	
XXIX	RIGHTS OF HOLDER	226
	§ 174. Holder in Due Course	
	175. Defects of Title	
	176. The Rights of a Holder in Due Course	
	177. Effect of Irregular Transfer	

CHAPTER	PAGE
XXX LIABILITY OF PARTIES	229
§ 178. Liability of Maker	
179. Liability of Indorser	
180. Discharge of Indorser	
181. Liability of Guarantor	
182. Liability of Accommodation Signer	
XXXI PRESENTMENT FOR PAYMENT	234
§ 183. Necessity of Presentment	
184. Requirements for Presentment	
185. Presentment Excused	
186. When Due	
XXXII NOTICE OF DISHONOR	237
§ 187. Necessity of Notice	
188. Effect of Notice	
189. Form of Notice	
190. Time of Notice	
191. Where to Send Notice	
192. When Notice Is Not Required	
193. Protest	
XXXIII DISCHARGE OF NEGOTIABLE INSTRUMENTS	241
§ 194. When Discharged	
195. When Not Discharged	
196. Effect of Alteration	
XXXIV PROMISSORY NOTES	243
§ 197. Definition	
198. Liability of Maker	
199. Interest	
200. Demand Notes	
201. Effect of Renewal	
202. Note as a Gift	
XXXV BILLS OF EXCHANGE AND ACCEPTANCES	247
§ 203. Definition	
204. Liability of Maker, Drawer, and Acceptor	
205. Acceptance	
206. Dollar Acceptance	
207. Bank Acceptances	
208. Domestic Bank Acceptances	
209. Trade Acceptances	
210. The Discount of Acceptances	
211. Rules for Discount of Bank Acceptances	
212. Rules for Discount of Trade Acceptances	
213. The Drawee	
214. Presentment for Acceptance	
215. Protest for Non-Acceptance	
216. Bills in a Set	

CONTENTS

xiii

CHAPTER	PAGE
XXXVI BANK CHECKS	257
§ 217. Definition	
218. Checks as Evidence of Payment	
219. Signature of Drawer	
220. Presentment for Payment	
221. Bank's Relations with Depositor	
222. Bank's Relations with Holder	
223. Revocation	
224. Certification	
225. Fraud	
226. Checks as Gifts	

Part VI—Insurance

XXXVII FIRE INSURANCE	267
§ 227. The Parties	
228. Nature of the Contract	
229. Agents	
230. The Policy	
231. Premiums	
232. The Property Insured	
233. Warranties and False Representations	
234. Settlement of Losses	
XXXVIII LIFE INSURANCE	280
§ 235. Nature of Contract	
236. Insurable Interest	
237. The Parties	
238. The Policy	
239. Premium Rates	
240. Agents	
241. Right to Change Beneficiary	
242. Assignment of Policy	
243. Settlement of Losses	
244. Government Insurance for Soldiers and Sailors	
XXXIX SUNDRY INSURANCE CONTRACTS	290
§ 245. Enumeration	
246. Marine Insurance	
247. General and Particular Average	
248. Accident Insurance	
249. Health Insurance	
250. Group Insurance	
251. Liability Insurance	
252. Title Insurance	
253. Burglary Insurance	
254. Plate Glass Insurance	
255. Automobile Insurance	
256. Other Forms of Insurance	

Part VII—Employment

CHAPTER	PAGE
XL THE CONTRACT OF EMPLOYMENT	301
§ 257. Introduction	
258. Definition	
259. What Constitutes a Contract of Employment	
260. Independent Contractors	
261. Interpretation of Contract	
262. An Express Contract Cannot be Proved by Custom	
263. Wages	
264. Modification of Contract	
265. When Contract Begins	
266. Termination of Contract	
267. Termination of Contract by Breach	
268. Rights and Remedies	
269. Employment after Expiration of Contract	
XLI RELATIONS OF PARTIES	312
§ 270. Duties of Employee to Employer	
271. Duties of Employer to Employee	
272. Presumption with Regard to Joint Owners	
273. Wages	
274. Fines, Deductions, etc.	
XLII EMPLOYER'S RESPONSIBILITY	324
§ 275. Introductory	
276. Doctrine of Assumption of Risk	
277. Doctrine of Contributory Negligence	
278. The Fellow-Servant Rule	
279. Employers' Liability Acts	
280. Workmen's Compensation Acts	
281. Modern Statutory Law	
282. Schedules of Compensation	
283. Who are Entitled to Compensation	
284. Employer's Defenses Taken Away by the New Act	
285. Third Persons	

Part VIII—Partnership

XLIII INTRODUCTORY	339
§ 286. Definition	
287. Partnerships Distinguished from Non-Partnership Organizations	
XLIV THE CONTRACT OF PARTNERSHIP	344
§ 288. Parties	
289. Kinds of Partners	
290. Partnership Contracts	
291. The Firm Name	
292. Partnership a Personal Relation	
293. Classification of Partnerships	

CONTENTS

XV

CHAPTER	PAGE
XLV PARTNERSHIP PROPERTY	353
§ 294. Nature of Partnership Property	
295. Liability of Partnership Property for Debts	
296. Profits	
XLVI POWERS AND LIABILITIES OF PARTNERS	361
§ 297. Powers of Partners	
298. Liabilities to Copartners	
299. Intra-Partnership Relations	
300. Liabilities to Third Persons	
XLVII TERMINATION OF PARTNERSHIP	368
§ 301. Termination by Agreement	
302. Enforced Dissolution	
303. Winding up the Business	

Part IX—Corporations

XLVIII NATURE OF CORPORATIONS	377
§ 304. Corporate Entity	
305. Classification	
306. Corporations Without Capital Stock	
307. Corporations With Capital Stock	
308. Distinctive Features	
309. (1) Creation by the State	
310. (2) Limited Powers	
311. (3) Limited Liability	
312. (4) Legal Entity of Corporation	
313. (5) Permanence	
314. (6) Stock System	
315. (7) Corporate Mechanism	
316. Attractiveness to Investors	
317. Disadvantages of the Corporate Form	
XLIX THE CHARTER	385
§ 318. Definition—Synonyms	
319. Charter Powers—General	
320. (1) To Sue and Be Sued	
321. (2) To Use a Seal	
322. (3) To Buy, Sell, and Hold Property	
323. (4) To Appoint Directors, Officers, and Agents	
324. (5) To Make By-Laws	
325. (6) To Dissolve Itself	
326. (7) To Do All Things Necessary	
327. Charter Powers—Special	
328. Things Ultra Vires	
329. Amendment of Charter	

CHAPTER	PAGE
L INCORPORATION	391
§ 330. Application for Incorporation	
331. Incorporators	
332. Name of Corporation	
333. Purposes	
334. Capitalization	
335. Shares	
336. Location	
337. Duration	
338. Number of Directors	
339. Classification of Stock	
340. Cumulative Voting	
341. Execution of Certificate	
342. Filing and Recording	
343. De Facto Corporation	
344. Contracts Prior to Incorporation	
LI BY-LAWS	398
§ 345. Definition	
346. Adoption	
347. Amendment	
348. Enforcement	
LII STOCK	401
§ 349. Capital Stock	
350. Stock Certificates	
351. Capital Stock vs. Capital	
352. Unissued and Issued Stock	
353. Full-Paid Stock	
354. No Par Value Stock	
355. Common Stock	
356. Preferred Stock	
357. Treasury Stock	
358. Lost Certificates	
359. How Transferred	
LIII STOCKHOLDERS AND THEIR MEETINGS	410
§ 360. Incorporators	
361. What Constitutes a Stockholder	
362. Rights of Stockholders	
363. Powers of Stockholders	
364. Liabilities of Stockholders	
365. Stockholders' Meetings	
366. Quorum	
367. Voting	
368. Voting Trusts	
369. Proxies	
LIV DIRECTORS AND OFFICERS	41
§ 370. Status and Functions of Directors	
371. Number and Authority	
372. Liabilities	
373. Qualifications	

CONTENTS

xvii

CHAPTER		PAGE
	§ 374. Vacancies and Removal of Directors	
	375. Regular Meetings	
	376. Special Meetings	
	377. Quorum	
	378. Officers	
	379. Salaries	
	380. Vacancies and Removal of Officers	
	381. Dividends	
	382. Bank Deposits	
	383. Execution of Contracts	
	384. Corporate Seal	

VOLUME II

Part X—Real and Personal Property

LV	PROPERTY RIGHTS	427
	§ 385. Origin of Property	
	386. Rights to Personal Property	
	387. Rights Classified	
LVI	REAL AND PERSONAL PROPERTY DISTINGUISHED	430
	§ 388. Personal Property Defined	
	389. Real Property Defined	
	390. Questionable Cases	
	391. Fixtures	
LVII	TITLE TO PERSONAL PROPERTY	433
	§ 392. Title	
	393. Original Title	
	394. Derived Title	
	395. Accession	
	396. Confusion	
	397. Kinds of Ownership	
LVIII	TRANSFER OF PERSONAL PROPERTY	438
	§ 398. Gift	
	399. Sale	
	400. Chattel Mortgage	
	401. Conditional Sales	
LIX	ESTATES IN REAL PROPERTY	442
	§ 402. The Nature of Real Property	
	403. Right to Real Property	
	404. Estates in Real Property	
	405. Remainders and Reversions	
	406. Vested and Contingent Remainders	
	407. Executory Devises	
	408. Time Limit to Effect and Executory Devise	
	409. Dower and Curtesy	
	410. Homestead	

CHAPTER	PAGE
411. Easements	
412. Joint Tenancies and Tenancies in Common	
413. Trusts	
LX TITLE TO REAL PROPERTY	452
§ 414. Original Title	
415. Acquired Title	
LXI TRANSFER OF REAL PROPERTY	454
§ 416. Conveyance of Real Property	
417. Warranty Deed	
418. Record of Deeds	
419. Restrictions in Deeds	
420. Searching Title	
421. Mortgage of Real Property	
422. Foreclosure	
423. Kinds of Mortgages	
LXII LANDLORD AND TENANT	467
§ 424. Lease of Real Property	
425. Parties to a Lease	
426. Rights and Duties of a Landlord	
427. Rights and Duties of a Tenant	
428. Expediency of a Written Agreement	
Part XI—Wills and Inheritance	
LXIII DISTRIBUTION OF PROPERTY OF AN INTESTATE	475
§ 429. Definitions	
430. Rules of the Common Law	
431. What Will Become of Real Property	
432. What Will Become of Personal Property	
433. Is It Wise to Make a Will?	
LXIV HOW TO MAKE A WILL	485
§ 434. Who Can Make a Will	
435. Restrictions on the Power of Making a Will	
436. General Form for Wills	
437. Kinds of Wills	
438. Executors	
439. Trustees	
440. Trust Estates	
441. Statutes	
442. How to Dispose of Real Property	
443. How to Dispose of Personal Property	
444. The Residuary Clause and Its Uses	
445. What to Do with the Will	
LXV HOW TO CHANGE OR TO REVOKE A WILL	501
§ 446. How to Change a Will	
447. How to Revoke a Will	

CONTENTS

xix

CHAPTER	PAGE
LXVI OTHER WAYS OF DISPOSING OF PROPERTY AFTER DEATH	504
§ 448. Deeds of Trust	
449. Gifts in View of Death	
LXVII THE SETTLEMENT OF AN ESTATE	506
§ 450. If the Deceased Person Left a Will	
451. If the Deceased Person Did Not Leave a Will	
452. Settlement Without Administrator	
LXVIII DUTIES OF EXECUTORS AND ADMINISTRATORS . . .	512
§ 453. The Procedure of Administration	
454. Inventory	
455. Advertising for Claims	
456. Paying Legacies	
457. Caring for Funds	
458. An Executor's Authority	
LXIX QUESTIONS BETWEEN LIFE TENANT AND REMAINDERMAN	518
§ 459. How Conflicting Rights Arise	
LXX INTERMEDIATE AND FINAL ACCOUNTS	521
§ 460. The Obligation Account	
461. Kinds of Accounts to be Filed	
462. Final Accounting	
463. Preparing Accounts	
LXXI RIGHTS IN PROPERTY WHEN THERE IS NO WILL . . .	524
§ 464. In the Case of Real Property	
465. In the Case of Personal Property	
466. Rights of a Husband or a Wife	
467. What Creditors Must Do	
LXXII RIGHTS IN PROPERTY LEFT BY WILL	528
§ 468. If Real Property Has Been Devised By Will	
469. If Personal Property Has Been Left By Will	
470. Contesting a Will	

Part XII—Personal Relations

LXXIII HUSBAND AND WIFE	535
§ 471. Persons Who May Marry	
472. What Constitutes a Marriage	
473. Personal Rights of Husband and Wife	
474. Rights of Husband and Wife in Each Other's Property	
475. Rights of Husband or Wife In Case the Other Is Injured	
476. Divorce	

CHAPTER	PAGE
LXXIV PARENT AND CHILD	546
§ 477. Duties and Rights of Father in Relation to Child	
478. Duties and Rights of Mother in Relation to Child	
479. What Duties and Rights May Be Claimed By Adopted Children	
480. Children as Criminals	
LXXV GUARDIAN AND WARD	551
§ 481. Personal Guardian	
482. Guardian of Property	
Part XIII—Suretyship	
LXXVI THE CONTRACT OF SURETYSHIP OR OF GUARANTY	557
§ 483. Definition	
484. Nature of Contract	
485. Written Contract	
486. Parties	
487. Consideration	
488. Delivery and Acceptance	
LXXVII RIGHTS OF SURETY OR GUARANTOR	562
§ 489. Notice	
490. Defenses	
491. Reimbursement	
492. Subrogation	
493. Contribution	
494. Extension of Time	
495. Discharge	
Part XIV—Debts and Interest	
LXXVIII DEBTS	569
§ 496. Definitions	
497. Evidences of Debt	
498. Open and Stated Accounts	
499. Receipts and Releases	
500. Part Payment in Full Settlement	
501. Accord and Satisfaction	
502. The Appropriation of Payment	
503. Equitable Jurisdiction in Actions for an Accounting	
LXXIX ENFORCING PAYMENT OF DEBTS	575
§ 504. When the Creditor Has Some Security for the Debt	
505. Where There Is No Security for the Debt	
506. Attempts to Defraud Creditor	
507. The Modern Theory of Credit	
508. Liens	
509. Attachment	
510. Execution	
511. Garnishment	

CONTENTS

xxi

CHAPTER		PAGE
LXXX	INTEREST	584
	§ 512. Interest	
	513. Discount	
	514. Usury	
	515. Compound Interest	
	516. Partial Payments	

Part XV—Bankruptcy

LXXXI	ASSIGNMENT FOR THE BENEFIT OF CREDITORS	591
	§ 517. Introductory	
	518. Rights of Debtors	
	519. Rights of Creditors	
	520. Void Assignments	
	521. Rights and Duties of an Assignee	
	522. Form of the Assignment	
	523. Revocation of Assignment	
	524. Insolvency	
LXXXII	BANKRUPTCY PROCEEDINGS	598
	§ 525. Receivership	
	526. Bankruptcy	
	527. Voluntary Bankruptcy	
	528. Involuntary Bankruptcy	
	529. Persons Who May Bring Bankruptcy Proceedings	
	530. Persons Who May Become Involuntary Bankrupts	
LXXXIII	BANKRUPTCY PROCEEDINGS (CONTINUED)	604
	§ 531. How Bankruptcy Proceedings Are Instituted	
	532. The Referee	
	533. Procedure	
	534. Creditors	
	535. Rights and Duties of Receiver	
	536. Rights and Duties of Trustee	
	537. Rights and Duties of Bankrupts in Bankruptcy Proceedings	
	538. Preferred Creditors	
LXXXIV	DISCHARGE IN BANKRUPTCY	613
	§ 539. Discharge of a Bankrupt	
	540. What Debts Remain Undischarged	

Part XVI—Bailments and Common Carriers

LXXXV	BAILMENTS	619
	§ 541. What Is Meant by Bailment	
	542. Kinds of Bailment	
	543. Mandate and Deposit	
	544. Commodatum or Loan	

CHAPTER	PAGE
§ 545. Pledge or Pawn 546. Hiring of a Chattel 547. Bailment for Custody, Services, or Transport 548. The Contract of Bailment 549. Property Rights 550. Duties of a Bailee 551. Dissolution of Bailment	
LXXXVI COMMON CARRIERS	629
§ 552. Common Carriers 553. The Lien of The Common Carrier 554. The Termination of the Bailment 555. Interstate Commerce Commission 556. Bills of Lading 557. Carriers of Passengers 558. Telephone and Telegraph Companies	
 Part XVII—Patents, Trade-Marks, and Copyrights	
LXXXVII PATENTS	639
§ 559. Constitutional Authority 560. Introductory 561. Who May Obtain a Patent 562. What Inventions are Patentable 563. What Is Unpatentable 564. Procedure to Obtain Patent 565. Procedure in the Patent Office 566. Interference Proceedings 567. Final Decision 568. Government Fees and Grant 569. Marking a Patented Article 570. Design Patents 571. Foreign Patents 572. Assignments and Licenses 573. Joint Inventors 574. Infringements 575. Official Publication 576. Practical Information	
LXXXVIII TRADE-MARKS	654
§ 577. Description 578. Common Law Trade-Marks 579. Essential Elements of a Trade-Mark 580. What May Not Be Used 581. What Can Be Used 582. The Common Law Right 583. Trade-Marks are Not Assignable Apart from Business 584. Summary	

CONTENTS

xxiii

CHAPTER	PAGE
LXXXIX REGISTRATION OF TRADE-MARKS	660
§ 585. The Federal Trade-Mark Law	
586. The Ten-Year Clause	
587. Who May Register a Trade-Mark	
588. Procedure for Registration	
589. What Will Bar a Trade-Mark	
590. Opposition to Registration	
591. Amendments, Rejections, and Appeals	
592. Certificate of Registration	
593. Assignments	
594. Foreign Registration	
XC TRADE-NAMES AND UNFAIR COMPETITION	666
§ 595. Unfair Competition Defined	
596. Trade-Names	
597. Secondary Meaning	
598. Personal and Corporate Names	
599. Geographical Names	
600. Imitation of Packages	
601. Other Forms of Unfair Competition	
602. Price Cutting	
XCI COPYRIGHTS	675
§ 603. Definition	
604. Who May Obtain Copyright	
605. Subject Matter of Copyrights	
606. The First Step	
607. Subsequent Procedure	
608. Making Out the Application for Copyright	
609. The Affidavit	
610. The Fees	
611. The Books Deposited	
612. Time for Filing Copyright	
613. Renewals	
614. British Copyright	
Part XVIII—Taxation	
XCII LAYING TAXES	687
§ 615. Who Has the Right to Lay Taxes	
616. Purposes for Which Tax May Be Laid	
617. Methods of Taxation	
618. Extent to Which Persons May Be Taxed	
XCIII COLLECTING TAXES	693
§ 619. Assessment of Real Property	
620. Assessment of Personal Property	
621. Payment of Taxes	
622. Taxation of Corporations	
623. The Federal Income Tax	

Part XIX—Arbitration

CHAPTER	PAGE
XCIV ARBITRATION AND LAW	701
§ 624. Advantages of Arbitration	
625. Objections to Arbitration	
626. Statutory Arbitration	
627. Agreement for Arbitration	
628. Withdrawal from Arbitration	
629. Hearings	
630. Signing the Award	
631. Enforcing the Award	
632. Setting Aside the Award	

Part XX—Law and Lawyers

XCV STUDY OF LAW FOR BUSINESS MEN	711
§ 633. Law Books for Study	
634. Law Books for a Busy Man	
635. The Case Method of Legal Study	
636. Taking a Law Course	
637. Courses in Commercial Law	
XCVI CHOOSING A LAWYER	716
§ 638. The Legal Profession	
639. The Domination of Precedent	
640. The Conservatism of the Law	
641. Ethical Standards of the Bar	
642. The Criminal Lawyer	
643. Selecting a Lawyer	
644. Lawyers' Compensation	
XCVII LAW AS A VOCATION	726
§ 645. Necessity of the Work of a Lawyer	
646. The Work of the Family Lawyer	
647. Business and Public Life	
648. The Effect of Legal Training	
649. The Dignity of the Profession	
650. Law as a Practical Vocation	
651. Succeeding in the Law	
652. Deceptive Statistics	
653. Practical Directions	

Part XXI—Forms

XCVIII DRAFTING A CONTRACT	739
Form	
1. The Contract as Drafted	

CONTENTS

XXV

CHAPTER	PAGE
XCIX EVIDENCING AN INSTRUMENT	744
Form	
2. Agent's Signature	
3. Corporate Signatures to Letters	
4. Corporate Signature	
5. Testimonium Clause—Two Corporate Signatures	
6. Testimonium Clause—Corporate and Individual Signatures	
7. Attestation Clause	
8. Attestation Clause in a Will	
9. Acknowledgment of Individual Person	
10. Acknowledgment of Attorney	
11. Clerk's Authentication	
12. Affidavit	
C CONTRACT FORMS	757
Form	
13. Simple Contract	
14. Contract by Letters	
15. Unilateral Contract	
16. Formal Contract	
17. Corporate Contract	
18. Assignment of Contract	
19. Assignment of Contract—Indorsement Form	
CI FORMS OF SALES CONTRACTS	762
Form	
20. Memorandum of Sale	
21. Contract of Sale by Letters	
22. Conditional Sales Contract	
23. Bill of Sale—Personal	
24. Bill of Sale—Personal	
25. Contract of Warranty	
CII AGENCY FORMS	767
Form	
26. Appointment of Special Agent	
27. Appointment of General Agent	
28. Power of Attorney	
29. Power of Attorney—Corporate	
30. Revocation of Power of Attorney	
31. Proxy—Simple Form	
32. Proxy—Unlimited	
33. Revocation of Proxy	
CIII FORMS OF NEGOTIABLE INSTRUMENTS	773
Form	
34. Check by Individual	
35. Corporate Check	
36. Corporate Indorsement of Check	
37. Voucher Check	
38. Note by Individual	
39. Corporate Note—by President	

CHAPTER	PAGE
Form	
40. Corporate Note—By Treasurer	
41. Corporate Note—Collateral Security	
42. Sight Draft	
43. Bank Acceptance	
44. Trade Acceptance	
45. Certificate of Protest	
CIV FORMS OF EMPLOYMENT CONTRACTS	781
Form	
46. Contract of Employment—Simple Form	
47. Contract of Employment	
48. Contract of Employment by Letters	
49. Contract of Employment with Share in Profits	
CV PARTNERSHIP FORMS	784
Form	
50. Simple Articles of Partnership	
51. Articles of Copartnership	
52. Sundry Partnership Clauses	
CVI CORPORATE ORGANIZATION FORMS	788
Form	
53. Subscription List	
54. Stock Certificate—Common Stock	
55. Assignment of Stock Certificate	
56. Certificate of Incorporation—New York	
57. By-Laws—Simple Form	
CVII FORMS FOR CORPORATE MEETINGS	797
Form	
58. Call and Waiver for Special Meeting of Directors	
59. Agreement to Consent Meeting of Directors	
60. Notice of Special Meeting of Directors	
61. Minutes of Special Meeting of Stockholders	
62. Minutes of Regular Meeting of Directors	
63. Motions	
64. Directors' Resolutions	
65. Certified Resolution Designating Bank	
CVIII MISCELLANEOUS CORPORATE FORMS	804
Form	
66. Resignation of Director—Tentative	
67. Resignation of Director—Peremptory	
68. Report of Committee on By-Laws	
69. Treasurer's Affidavit—Corporate Statement	
CIX REAL AND PERSONAL PROPERTY FORMS	807
Form	
70. Chattel Mortgage	
71. Lease	
72. Deed With Full Covenants	
73. Real Estate Mortgage	

CONTENTS

xxvii

CHAPTER	PAGE
CX SUNDRY FORMS	811
Form	
74. General Release	
75. Will	
76. Bill of Lading	
77. Guaranty Contract	
78. Guaranty Contract by Letter	
79. Agreement for Arbitration	

Appendix

APPENDIX A—CHART SHOWING JURISDICTION OF STATE COURTS	821
B—A PROFESSIONAL LAW LIBRARY	822
C—GLOSSARY	826

BUSINESS LAW

PART I

THE LAW OF THE LAND

CHAPTER I

EVOLUTION OF LAW

§ 1. Definition

The English word "law" has a variety of meanings. We talk loosely of the law of gravitation, civil law, common law, written law, ecclesiastical law, the laws of health, the laws of God, etc., etc. For the sake of clearness it is necessary in this book to limit the word to those rules of action and conduct which regulate our relations with our fellow men.

The legal definition of law is "a rule of action prescribed by the supreme authority," and to that is usually added, "commanding that which is right and prohibiting that which is wrong." This last part of the definition must always be qualified by the explanation that the words "right" and "wrong" in this connection are to be construed as *legally right* and *legally wrong*. At times what is legally right may be morally wrong, and at other times what is legally wrong may be morally right.

§ 2. The Origin of Law

It is impossible to imagine any state of society without some law, that is, some "rule of action." A solitary man in an uninhabited country might be said to be without law, but as soon as one other human being came into any relation with him, certain rules and customs would grow up to regulate their mutual rights, and these would soon have the form and the force of law. Children in their play have rules and customs to govern their actions. Among the students of every college

there is a curiously complex system of rules and customs, rigidly enforced, which defines the rights and the duties of the different classmen and their relations to others in the college.

A simple people living in a sparsely settled country could get along with a minimum of law, but a highly organized people living in a densely populated country require many laws. Strangers used to comment on the number of "Es ist verboten" signs in Germany, but a complicated system of law is the necessary consequence of a dense population and a highly organized social structure.

§ 3. Law and Liberty

Laws are a necessary evil incident to social existence. The lone man in a wilderness has complete liberty. As others join him, laws and established rules become necessary. Every law and every rule subtracts from the individual's previous liberty of action and circumscribes his freedom. On the other hand, the advantages of social life and achievement are great; therefore the majority of mankind are willing to pay the price, which is submission to law. The trouble comes from the fractious few who, while they enjoy the advantages of living in a civilized community, are not willing to pay the price, and who seek to evade the laws which are obeyed by others and which alone make the civilized community possible.

§ 4. Sources of Law

The beginnings of our legal system go back to the early history of our country when the colonists from England first established courts, and decided the cases that came up according to the principles of the law of England as it existed at that time—that is, they utilized as much as was applicable to conditions prevailing in the colonies. This law was principally the famous "common law" of England that had grown up through centuries. Its provisions were of great advantage

to the colonists when the rights conferred by common law were infringed by the arbitrary acts of the home government.

They were able to show that the rights they claimed were conferred by the common law, and that the king and the parliament were seeking to deprive them of the common birthright of Englishmen.¹

Colonial Charters. Most of the colonies had been established under charters—instruments which served as our written constitutions do now. Connecticut and Rhode Island continued to use colonial charters as substitutes for constitutions even after the Revolution. To the common law were added the enactments of the colonial legislatures that had been established in each colony. The power of these colonial legislatures was limited by the provisions of the charter under which the particular colony existed.

Effect of the Articles of Confederation. At the time of the Revolution the colonies adopted the Articles of Confederation, which left each separate colony to establish such government as it saw fit. The authority of these governments was expressed usually in a constitution which took the place of the old charter and in legislative enactments passed to supplement the constitution and to apply general principles to particular cases.

The Federal Constitution. Later, when the Federal Constitution was adopted, its authority became supreme, and as each colony joined the new nation the local governments were shaped according to the basic principles of the Federal Constitution. The common law, the state constitutions and charters, and the enactments of state legislatures, all gave way on any point that conflicted with the Federal Constitution. This subject is treated more fully in the two succeeding chapters.

¹ Cooley's Constitutional Limitations, Chapter III.

REVIEW QUESTIONS

1. Give the legal definition of "the law."
2. What do you understand by "the supreme authority" in the definition?
3. Mention some action legally right but morally wrong.
4. How far is the law a guide to what is morally right?
5. Can you make men moral by law?
6. What is the origin of law?
7. What is the origin of the laws regulating the operation of automobiles? How far do they date back?
8. If a body of men were wrecked on an uninhabited island would they be subject to any law? What would probably happen?
9. Why are we willing to submit to law and lose our freedom to do as we choose?
10. What would be the condition of a community without any law?
11. What are the sources of the law in this country? Outline them in order of time. Outline them in order of authority.

CHAPTER II

THE WRITTEN LAW

§ 5. Definition

The technical term "written law" means law that is embodied in constitutions, acts of Congress, of state legislatures, and of other bodies with legislative authority. In many countries all the governing law is this so-called "written law." Napoleon, who had a better title to fame in the code of laws to which his name is attached than in all his conquests, called together the persons most learned in law to reduce into one orderly, compact body all the varying laws at that time prevailing in France. The "Code Napoleon" which was the result has from that time to the present day been the major law of France and is what we call "written law." No similar codification of all existing laws has ever been attempted in the United States, and our so-called "written law" is only a part of the body of law by which we are governed.

§ 6. Constitutional Government

Nevertheless in our country the written constitution is the basis of all law. This is true of the United States as a whole and also of each separate state. A written constitution is the fundamental law on which all other laws are based and to which they are all subject. A constitution has been explained as that written instrument which defines the powers of government and limits the exercise of those powers for the protection of individual rights. The power of Congress is derived from the Constitution of the United States. Each state legislature has only the power granted by the state constitution. "Con-

gress can pass no laws but such as the Constitution authorizes expressly or by clear implication."

§ 7. The United States Constitution

The Constitution of the United States is the highest authority in the United States. Next in rank come laws enacted by Congress in pursuance of the powers enumerated in the Constitution. For example, Congress has power to regulate commerce with foreign nations and among the several states, and under this authority it has passed the "Anti-Trust Law." On the other hand, the Constitution does not grant Congress any legislative power in regard to marriage and divorce, and for this reason Congress is not authorized to enact a federal law regulating divorces, however desirable such a uniform law might be. Under the present Constitution this matter is left to the discretion of the separate states, and divorce laws change as state lines are crossed.

At the time of the adoption of the Federal Constitution the representatives of the separate states were every whit as jealous of the rights of the states as we as a nation were jealous of the rights of the United States in the matter of the League of Nations. They clung to the sovereign rights of states and feared, worse than men ever feared war and pestilence, the sinking of the state in the nation. There is an extremely interesting parallelism between the arguments advanced against the adoption of the National Constitution by the states and those advanced against the adoption of the international constitution by the nation. The National Constitution as adopted was a compromise whose makers held that the powers of the United States as a nation were to be limited, so as to leave to the separate states the maximum of sovereignty. Their purpose in drafting the Constitution was to define these limits to national supremacy with exactitude and carefully to mark out the powers of Congress beyond which it could not

go. Fortunately, grants of power as expressed in the Constitution were couched in general language, and in interpreting their meaning the Supreme Court of the United States has, in many instances, placed a liberal construction upon them, so that Congress today is a far more powerful body than it otherwise would have been. For example, at the time the Constitution was adopted no one dreamed of the enormous power granted to Congress in the right "to regulate commerce between the states." The commerce between the states at the time the Constitution was adopted was of little significance and the power to regulate was of small moment. With the vast extension of our interstate commerce, however, the congressional power of regulation has grown to tremendous proportions. The recent decision of the Court in regard to the constitutionality of the Adamson railroad wage law would seem to extend this power almost without limit. The great war necessitated federal control of the railroads. Even though the roads are returned to their corporate owners, it is likely that there will be an increased supervision by the central government that will vastly and permanently expand the authority of the Federal Government.

The wonderful thing about the Constitution of the United States is that though it was devised over a century and a quarter ago, and though the changes in our country and in its modes of life, in its social relations, and in its methods of business have been tremendous, the old Constitution, with but few changes, still serves as the fundamental law of the land and chafes in but few places. Well did Bryce in his "American Commonwealth" say of it:

The Constitution of 1789 after all deductions ranks above every other written constitution for the intrinsic excellence of its scheme, its adaptation to the circumstances of the people, the simplicity, brevity, and precision of its language, its judicious mixture of definiteness in principle with elasticity in detail.

§ 8. Laws of Congress

The legislative power of Congress is limited to specific objects enumerated in the Constitution. Congress has the power to "regulate commerce with foreign nations and among the several states, and with the Indian tribes," but has no power to pass any laws affecting a railway or any kind of traffic which operates entirely within a single state. On the other hand, Congress is authorized to "coin money, regulate the value thereof and of foreign coin, and fix the standard of weights and measures"; this power gives us a system of coinage and of weights and measures which is uniform for the entire country. If ever we adopt the metric system it will be through the action of Congress, under this constitutional grant of power.

Whenever Congress acts under a constitutional grant of power, the states are excluded from legislation on that subject. For instance, Congress has power to pass "uniform laws on the subject of bankruptcy," and when the present bankruptcy law was passed in 1898 it at once nullified all the existing state laws on the subject of insolvency. Laws passed by Congress *in pursuance* of its constitutional powers are superior to state constitutions and state laws.

§ 9. State Constitutions

At the time of the adoption of the National Constitution, each of the thirteen original states was exercising the powers of government under some form of written constitution. These instruments remained in effect, except in those particulars which were overruled by the Constitution of the United States. The newer states have adopted constitutions, and before the states were admitted it was necessary for Congress to accept the proposed constitutions. But within the limits of each particular state the state constitution is supreme. The

state legislature cannot enact a law which goes counter to any of the provisions of the state constitution.

§ 10. Constitutional Amendments

It was intended by those who framed our system of government that amendment of the Constitution of the United States should be both difficult and slow. They did not intend that a majority of the voters should at any time amend the Constitution. They did not have such entire confidence in the wisdom of the common people as to be willing to empower a bare majority of the voters to set aside the constitutional provisions they had so carefully devised. So they provided that no amendment should be valid as a part of the Constitution unless it were first proposed by two-thirds of both Houses of Congress and afterwards ratified by three-fourths of the several states. As it was purposely made difficult to amend the United States Constitution, so most of the states have likewise made it more or less difficult to amend or to change their constitutions. In some states a convention for the special purpose of revising the constitution is called at stated periods; others leave to the legislature the calling of the conventions, while the usual plan is for the legislature to submit separate amendments to the people from time to time.

§ 11. Constitutions That Legislate

Constitutions are intended to be permanent, and therefore should lay down only broad principles. They should not be encumbered with legislation on any subject on which the policy or the best interests of the people are likely to change. The pressure for change has been quite as strong as the framers of the constitution foresaw.

At the present time many persons desiring to introduce reforms and to secure liberal legislation fret at the delays and the difficulties of overcoming constitutional impediments, and

hence advocate making our constitutions, both federal and state, easier of amendment and less restrictive in their provisions. There is such a distrust today, moreover, of the wisdom of legislatures that in many of the newer state constitutions provisions have been incorporated that should have been left for legislative action. For example, the Constitution of Oklahoma provides that eight hours shall constitute a day's work throughout the state; that railways shall not charge passengers more than two cents per mile, while the corporation commission may exempt any railway in case its earnings are so low as to justify a higher rate; that railways shall have adequate, comfortable, and clean stations, etc. By incorporating such detailed legislation in a state constitution, its function, which is to provide fundamental and basic law, is confused with that of the legislature, which is to provide laws for such specific subjects as hours of labor, rates of fare, and all sanitary details.

§ 12. Legislative Enactments

Next in dignity and authority to the state constitutions come the laws or acts of the separate state legislatures so far as they conform to the Constitution of the United States and the constitution of the particular state. These are known as statutes and are of authority in the state where they are enacted. Below them in dignity come the ordinances or laws of boards of aldermen and common councils in towns and cities. The law from all of these different sources—constitutions, laws of Congress, laws of legislatures, and ordinances of municipal governments—may be said to make up the body of what is called the "written law," in contradistinction to what we call the "unwritten law" which is discussed in the next chapter.

§ 13. Statute Law

The term "statute law" or "statutory law" is frequently used in contradistinction to the common law. In its general use it means all law expressed in constitutions, codes and enactments of the legislature, and is identical with the term "written law" as used herein. In a narrower sense it means the legislative enactments of the states or of the United States, which are published in volumes of statutes, or revised statutes, as "The Revised Statutes of the State of New York." In such a work will be found all the laws regulating the conduct and activities of the citizens and others in the state.

The common law gives way whenever it comes in conflict with the statute law. The legislature in each state has authority to supersede, extend or abrogate the common law. The common law is the old law that prevails until it is overruled by statutes of the United States or of a state legislature.

§ 14. Subsidiary Laws

In late years there has come into existence an immense additional body of written law consisting of the rules and regulations issued by boards of health, building boards, school authorities, and various bureaus and commissions. For instance, the Interstate Commerce Commission is empowered by Congress to regulate particular matters concerning the railroads. In most of the states there are railroad commissions with similar authority to regulate traffic within state boundaries. Moreover, the different transportation companies and the other corporations operating public utilities have the right to make reasonable regulations for the government of those using their facilities. Thus, in the aggregate, the "written" or "statutory" law comprises a vast number of legal and semi-legal enactments, from articles of the Constitution down to the rules of the trustees of the smallest school district.

REVIEW QUESTIONS

1. What is written law?
2. What is a constitutional government?
3. Does a constitution have to be written?
4. What is meant by a government of limited powers?
5. What is the highest source of law in the United States?
6. How have powers granted by the constitution been extended from time to time?
7. Why cannot Congress give us a system of uniform divorce laws?
8. Has Congress the right to debar from interstate commerce articles made by child labor? Give reason for your answer.
9. Why has it been made difficult to amend our constitution?
10. What is the difference between matters that should be embodied in a constitution and matters that are properly subject to legislative action?
11. Name in order of authority and dignity the sources of "written law."
12. Why has New York State a constitution, while New York City has not?
13. Name some congressional laws passed within recent years.
14. What laws are superior to a state constitution?
15. Name some laws passed by the legislature of your state within recent years.

CHAPTER III

THE UNWRITTEN LAW

§ 15. Definition

To the layman, perhaps, the term "unwritten law" is somewhat misleading. It is called unwritten law because there was a time when it was not written. As soon as men commenced to live in communities they found it necessary to conduct their intercourse and dealings according to rules, and these customs or uniform methods of doing things are supposed to be the foundation of what is now called the "common" or "unwritten law." For instance, when vehicles meet it is the custom in this country to turn to the right. This custom is not the enactment of any legislature, and yet it is practically a law, for if anyone driving a vehicle failed to observe it he would be liable for any damage that resulted. It might be possible to find cases where this particular matter had come up and received the ratification of a court decision, but in such cases the court did not make either the custom or the law; it merely recognized that the custom was general and hence had the force of law. That is, the court recognizes the custom as law, because men have acted in one way until that way has become a rule of action; the court is bound by it although there is no written record. When so recognized by a court, it would be placed upon the court records and so would actually be *written down*, yet it is still called "unwritten law" because it is based on the earlier unwritten custom instead of upon legislative enactment. Lawyers distinguish these classes by the Latin terms *lex scripta*—written law—and *lex non scripta*—unwritten law.

§ 16. The Doctrine of Precedents

The courts do more than record customs; they create law by decisions that then become precedents. In primitive days when men had differences of opinion they would get someone older and supposedly wiser than the rest, to arbitrate or decide the matter. When a given matter had once been decided in a certain way, the inhabitants of the country would shape their conduct according to this decision; it would be a precedent for future action and future decisions and in this way would become part of the unwritten law. Gradually, as civilization increased and these precedents accumulated, a "body" of unwritten law grew up, founded partly on customs and partly on precedents established by the courts.

Moreover, if a question came before one of these early courts and no custom could be found on which to base the decision and no precedent to guide it, the judge would decide according to his ideas of right and justice and thus would add a new item to the sum of this unwritten law, which in turn would become a precedent for later cases like it. England has been eulogized by its poet laureate as:

A land of settled government,
A land of old and fair renown,
Where Freedom broadens slowly down,
From precedent to precedent.

§ 17. Court Reports

In the old days when writing was a rare accomplishment, individual lawyers used to make their own notes of cases in what were called "Common-Place Books," which they would use as authorities when similar cases were tried. In this way there grew up the custom of making court reports. Today the decisions of the courts are most carefully recorded and published, and the court reports are the greatest repositories of this so-called "unwritten law."

§ 18. The Volumes of Reports

The difficulty in our country at the present time is that we have over forty-eight different and independent systems of courts, all grinding out decisions, which are recorded and published in long rows of volumes. In the first place the number of reports has become so great that it is impossible for even the most industrious lawyer to keep up with them. The existing law reports of this country fill thousands of volumes, and every year they are growing in number and complexity. In the second place, there are forty-eight separate jurisdictions, the decisions do not always harmonize, and then occurs a conflict of laws.

Lawyers depend on large law libraries to which they have access, kept up usually on a co-operative basis. Meanwhile, they subscribe for volumes of digests and use encyclopedias of law to guide them in their searches through this ever-increasing maze of judicial decisions. In each state the decisions of the highest state courts are paramount, and the lawyers in the state try to familiarize themselves with at least the trend of these decisions.

Whenever political, economic, and social conditions change so radically that the decisions of the higher courts become unjust or restrict legitimate activity too much, the state legislature interferes and enacts laws that supersede the judicial decisions. In other words, the written law prescribed by the legislature overrules the unwritten law that comes from the decisions of the court.

§ 19. Citations

When a lawyer wishes to use a case in argument, he cites it by naming the parties, the number and name of the report, and the page on which the case is found. Only by practice can a person know, when a case reference is given, what court

decision the author cites. It is no small part of a lawyer's training to know where to find the decision he wants. This matter of finding cited cases is explained in Appendix B.

§ 20. The Common Law

The unwritten law was also called, as has been said, the "common law," and old-school lawyers were fond of extolling it as the perfection of human wisdom. When this country broke away from England at the time of the Revolution we retained the English common law, and it became the foundation of the general system of law prevailing throughout most of this country. In Louisiana, however, and to a certain extent in Texas and California, the so-called Roman or "civil law" was introduced and became largely the foundation for the systems of law in those states. This system based on the old Roman law, prevails in Italy, France, and other Latin countries in Europe and is utilized by the Teutonic peoples as well. The English law is indebted to the Roman system more than English common law advocates are willing to admit, and it might have been better had more been borrowed.

The original English common law was a harsh and barbarous code, having little or no consideration for the rights of women and children and making man the tyrant of the family. Any infractions of its provisions were punished with drastic penalties. The smallest theft by man, woman, or child, was punished by death. At the present time most of the harsher features of the common law have been eliminated. Juries refused to convict prisoners on account of the cruel penalties, and the law has been modified by numberless legislative enactments and expanded by judicial construction, to fit a more civilized and cultivated society than that in which it originated.

It is evident that the term "unwritten law" covers a wider field than "common law." Therefore it is used in this work

to designate the law that is contained in the reports of the courts.

§ 21. Law-Merchant and Commercial Law

The law-merchant was originally a part of the general law of nations, being concerned with bills of exchange and the like, freights, average, demurrage, insurance, bottomry and other matters of the same nature pertaining to commerce.

Chancellor Kent in his commentaries says that the law-merchant "consists of certain principles of equity and usages of trade, which general convenience and a common sense of justice had established to regulate the dealings of merchants and mariners in all the commercial countries of the civilized world."

Blackstone refers to it as "The particular system of customs used only among one set of the king's subjects, called the custom of merchants, or *lex mercatoria*: which, however different from the general rules of the common law, is yet ingrafted into it, and made a part of it; being allowed, for the benefit of trade, to be of the utmost validity in all commercial transactions."

While the law-merchant had its origin in international usage, as a matter of fact it was incorporated into and made a part of the body of the common law of England and was with it transplanted to this country and made a part of our own common law so far as it was applicable to our conditions. In later years it has been largely extended and modified by statute but still remains part of our unwritten law and as such governs in the present course of trade and business.

The term law-merchant is generally applied to the old laws or customs of merchants. The corresponding modern term is commercial law, which is defined as the body of principles and rules, drawn chiefly from the customs of merchants, by which the rights and obligations arising in commercial transac-

tions are determined. It is also defined simply as the law applicable to commercial transactions.

§ 22. Unconstitutional Laws

It frequently happens that a legislative enactment designed to overrule some objectionable decision of the courts comes into conflict with a provision of the state constitution or of the United States Constitution and the courts may decide this new law to be unconstitutional. If the people in the state should still desire to maintain the legislative enactment, they would have to amend the state constitution except in states, Colorado for example, whose constitution provides for the "recall of judicial decisions" by the vote of the people. So far as the writer knows, however, this power has never been invoked, and indeed it seems a dangerous right since popular passion might easily be swayed to commit on occasion, in this way, great injustice. In case the law were in conflict with the Constitution of the United States, the people must either submit or else undertake the very arduous task of stirring up all the people in the country to amend the Federal Constitution.

A notable instance of this is the income tax law, which was passed by Congress but declared unconstitutional by the Supreme Court. Then the Constitution was amended, whereupon Congress passed the present income tax law which, with its amendments, will doubtless be a permanent feature of our system of taxation.

§ 23. The Recall of Judges

Within the last few years many persons have become impatient with the slow process of changing the Constitution. This has led them to advocate, as a short cut to securing better laws, the recall, that is, the dismissal, of any judges who decide that popular laws are unconstitutional. If this law went into

effect any judge who rendered decisions opposed by the majority of the voters could be recalled and a more subservient arbitrator elected. For several reasons such a procedure seems unwise. It would be better to facilitate the process of amending the Constitution than to seek judges who will disregard the plain letter of existing law and will support, as legal, laws that plainly are not in harmony with the provisions of the Constitution. But this is too large a subject for treatment here.

REVIEW QUESTIONS

1. Give some examples of custom-made law.
2. When a custom is recognized by a court and its decision is recorded, what is the effect?
3. What is the argument for observing precedents?
4. What is the disadvantage of our numerous volumes of reports?
5. In what cases do legislative enactments supersede court decisions?
6. Give the arguments for and against the recall of judges.
7. What is the relation between the common law and statute law?
8. Where do we get our common law?
9. What countries have laws most nearly like ours?

CHAPTER IV

LAW AND EQUITY

§ 24. Remedial Law

When anyone has suffered wrong and his legal rights have been infringed, he seeks a remedy. The law itself may be ideal, but if the machinery to enforce the rights defined by the law be defective, abstract perfection will avail but little. Therefore a study of what is called remedial law is necessary before we can tell what real help we are likely to obtain from the law. The "law's delay" is proverbial. In all matters of judicial procedure there has always been a tendency to formality and "red tape." Too often this tendency becomes so excessive that it nullifies the remedy and results in a denial of justice. The remedy may be so costly and long deferred that it were better left unsought. The man with limited means is too often, on this account, barred from seeking justice.

Suits or actions to redress wrongs or to enforce rights are classified as suits at law and suits in equity. It is not easy to explain briefly the distinction between the terms "law" and "equity" as they are used in our administration of justice. The two words are used in this connection without any reference to the ordinary meaning attached to them. A real, technical distinction exists between a case at law and a case in equity which a lawyer must thoroughly understand. Whether it would pay a business man to study out the exact and full distinction between the two is doubtful. But, as it is impossible for a lawyer to avoid using the terms in their technical sense, it is important that the layman should have a general idea of what the lawyer means, so that the plain

man may not be misled by confusing the ordinary English use of the words with the legal signification.

§ 25. Equity in the Legal Sense

In England many years ago the proceedings at law had become so cumbersome and so limited in scope that it was difficult to obtain justice in the courts of common law. King Henry VII then provided that in those cases in which the common law did not afford a remedy, relief could be obtained by applying directly to his chancellor. This official, who was also a dignitary of the church, favored the Roman or civil law and adopted a procedure founded on that law in contradistinction to the common law. Such a procedure before the chancellor was called a suit in "chancery" or "equity," as distinguished from the procedure "at common law" or simply "at law." It should be noted, however, that while at first it was simpler to bring a suit in equity than at law, this distinction soon vanished and equity proceedings became even more complex and technical than the procedure at law. The chancellor, however, gave relief in many cases for which the common law gave no remedy. The common law was adapted to a simple life and a crude social system. As the English people advanced the deficiencies of the common law were manifest and the introduction of the courts of equity was a long step in legal reform. The two distinct systems both continued; the procedure was different, the rules were different, and the relief given was different. The lawyers who practiced before the chancellor were called solicitors; the lawyers who appeared in the common law courts were counselors or barristers.

In equity the remedies are different from those provided by a suit at law. To illustrate the difference, if anyone breaks down your fences and makes a road across your property, at *law* you can sue only for damages; in *equity* you can ask an

injunction restraining the offender from further trespass, and also recover for any damage he may have done.

§ 26. Suits at Law and in Equity

The distinction between law and equity was brought to this country and as a result there are in all the states the two divisions of the work of the courts and the two methods of bringing suit. In a few states the law and the equity courts are kept entirely separate, as is the case in New Jersey; and in these states the public realizes more readily the real difference between law and equity administration. But in most states today, the actions are brought in the same courts, the only differences being in the preliminary procedure, in the remedies which the courts grant, and in the fact that in most cases at law there is a jury trial, while in equity cases a judge or judges alone hear the case.

A court of law hears both civil and criminal cases. Civil cases are the ordinary suits about contracts and property rights and are brought by private parties against other private parties. Criminal cases are suits brought by the state itself against those who are accused of having broken the law, and who are punishable by fine or imprisonment. In such a case the fine goes to the state. (See Chapter V.)

A court of equity hears only civil cases. If a person is interfering with another's rights, a court of equity will grant an injunction forbidding him to do so in the future, and will at the same time make him pay damages to the injured party for the wrong which has already been done.

§ 27. Bringing a Suit at Law

When A refuses to pay a debt that is due, or fails to do what he has contracted to do, or by his negligence or wrongdoing has caused damage to B, if B wishes to bring suit against A he employs a lawyer who prepares a written statement

setting forth his client's cause of action. This paper is called a complaint and must be served upon A. At the same time with or before the service of the complaint, B must serve a notice or summons on A requiring him to answer within a certain number of days. If A does not appear, the court will consider that A does not mean to defend and, in some instances, if the claim is definite, it will grant a judgment by default against A and in favor of B, without a trial or anything more than a sworn complaint to prove the case.

Service of a summons must be made personally upon a defendant except:

1. Where the person is an infant, it may be delivered to a parent or guardian.
2. Where the person is adjudged insane or incompetent to manage his own affairs, it may be delivered to a guardian or to the defendant.
3. Where a person, firm, or corporation is without the state, summons may be served by publication of the summons in two newspapers, most likely to be seen by the defendant, for a specified time of not less than once a week for six successive weeks. (The details given are for publication in New York. They vary in the different states.)

The party bringing the action is called the "plaintiff," or in some states the "complainant." The party against whom the action is brought is called the "defendant." If the defendant does not wish to allow judgment to go against him by default, he or his lawyer must within the time set serve an answer to the other party's complaint against him. In this paper the defendant usually brings forward any cause of action which he may have against the other party. This is called a counterclaim. The written papers by which the parties bring their cause before the court are called "pleadings." If the

defendant denies the facts alleged or sets up a counterclaim, the pleading is called an answer.

The other party then replies to the counterclaim. There may in some states be several such replies after the service of the complaint. The procedure depends on the law of the particular state where the action is being brought. Each party must serve a copy of each paper in the action on the other party or his attorney.

If what has been stated in the complaint does not make a legal cause of action, the defendant through his lawyer may object to it by filing a demurrer. A demurrer objects to the complaint on legal grounds; for example, that it is not brought in the right court, or that the facts alleged, even if true, do not constitute a cause of action.

Then the matter of the demurrer comes up before the court. It is argued by the lawyers on each side, and if the court decides that the demurrer presented by the defendant is well taken, the complaint is dismissed. The plaintiff can then usually get leave (by paying the costs up to date) to file a new complaint in which his lawyer will try to avoid the particular legal difficulty.

If the court decides, however, that the demurrer is not well taken, it is dismissed, and this leaves the defendant to answer the complaint as to the facts, that is, as to the matters which have been alleged on the part of the plaintiff and denied on the part of the defendant.

The foregoing statement of proceedings before trial presupposes very simple proceedings, but usually there are requests to amend and much incidental procedure, which tend to delay the trial of the main issue.

§ 28. Trial at Law

When the parties have finally *come to an issue*, i.e., when the plaintiff has alleged certain things and the defendant has

denied them or has interposed a defense, then the case is set down for trial, and takes its place on the court calendar. When cases that are ahead of it on the calendar have been tried, or postponed, the case is called, and the lawyers on each side are asked if they are ready. When both sides are ready, or have no excuse for longer delay, a jury is assembled and the judge proceeds with the case. In a court of law a party has a right to have a jury decide any disputed facts.

The witnesses for each side are sworn and testify, then the case is argued by counsel for each party and goes to a jury to decide or is decided by the judge, or is taken under advisement by the judge, who will give his decision after due consideration. If the case goes to a jury, the jurymen are placed in the custody of a court officer until they reach a decision or find that they cannot agree. If the judge is to decide the case and takes it under advisement, it may be days, weeks, or months before he will render his decision.

Since a jury is composed of human beings, it is likely to show certain very human characteristics in its decisions. The sympathies of the jury are usually with the under dog, whether he is plaintiff or defendant. Often the plaintiff, by the mere fact of going to court with his troubles and then by being heard *first*, has the better chance. If one party is a corporation, the jury is inclined to regard it as a soulless oppressor, and to award damages in favor of the poor workingman, widow, etc., whom the corporation is supposed to be injuring.

Very frequently clever and unscrupulous lawyers get in some touch to appeal to the sympathies of the jury, as a photograph of an injured man's wife and children, etc. These are usually ruled out by the court, but the effect on the jury has been gained just the same. It is to be remembered that if one man on the jury is stubborn, prejudiced, or dishonest, he can prevent a verdict and the whole expense and trouble of the trial has to be repeated. The law frequently breaks down in

vindicating rights because of the imperfect workings of the jury system.

Note:

1. Consider all the chances before bringing a lawsuit.

§ 29. Bringing a Suit in Equity

The outline given applies to a court of law. If the court is a court of equity jurisdiction, the procedure is essentially the same except that the first statement may be called a petition or a bill in equity. In New York complaints are also used in equity. All procedure in courts follows generally the lines laid down, with many variations as to details and incidentals.

A suit in equity can be brought only when the party cannot obtain justice at law. The other party must answer the petition or the bill. Copies of all papers must be served on the opposite party by the party making the charges.

In a suit in equity, only a judge, or several judges, hear the case. For this reason a court of equity is not so strict about keeping out evidence that does not properly have anything to do with the case, or that might prejudice a jury. The judge is supposed to know the law and to be guided only by such evidence as ought to be allowed to affect the decision of the case.

A court of equity tries to give a remedy to fit the nature of the wrong that is being done. If the wrong consists in a refusal to perform a contract, the court will, in some instances where the contract should be performed, compel the offending party to carry out his agreement. (See Chapter XII.) If the wrong alleged consists in the defendant's continuing to do anything which is injuring another, the court will issue what is called an injunction forbidding the continuance of the injurious conduct. Practically speaking, however, the courts are chary of granting an injunction where it may be avoided.

It is useless to attempt to bring an action in equity unless

the party is certain that he can prove to the court that the damages which he can obtain at law will not compensate him for his injury, and unless he is willing to do everything which the court may require from him in the interests of justice. The maxim is that he who seeks equity must do equity.

Another maxim in equity is that he who comes into a court of equity must come with clean hands, i.e., if the complainant alleges fraud, he must show that he has been scrupulously fair in all his own dealings.

If the party resorts to equity when he should have instituted an action at law, he will merely find that he is obliged to go to the added expense of bringing action at law. The practice in equity is no less complicated than that at law.

§ 30. Appeals to a Higher Court

The decision of a trial may be appealed from by the dissatisfied party. The unsuccessful litigant has to pay the damages adjudged to be due his opponent, the costs of the suit, and the fees of his own lawyer. His fighting blood is stirred by the evidence that brings to mind the original dispute and the perverseness of the opposite party, by the arguments of the counsel on each side, and by the failure of the court and jury to give them the weight he feels they have, and he feels as if he would spend all he has to vindicate himself and to punish those who have wronged him.

His lawyer feels much the same way, and, as he is paid for appealing instead of having to pay, he can better afford to indulge his feelings. Usually the first thing is to file exceptions to the alleged irregularities in the trial; that is, happenings of the following nature:

That evidence was admitted which should have been shut out.

That evidence was rejected which should have been admitted.

That questions were allowed which should have been barred.

That questions were disallowed which should have been allowed.

That the judge charged the jury in a way he should not have charged it.

That the judge refused to charge the jury as requested and as he should have charged it.

That the verdict was excessive, or inadequate, or not supported by the evidence.

Then a motion is made for a new trial and, if this is overruled, counsel announces that he will appeal. The losing party cannot commence a new action. He is barred from any such proceeding, otherwise a wealthy plaintiff could ruin his opponent by continued new actions. He can, though, in most cases appeal to a higher court.

The appeal is a costly and complicated proceeding. All of the papers and much, in some cases all, of the evidence must be printed. Then the arguments of each of the opposing counsel, ironically termed "briefs," are printed. After more delay and often much sparring of counsel over points of procedure, the case will take its place on an appeal docket and in due course will be reached by the appellate court. Next the case is heard, which means that counsel for both sides appear and argue the case on appeal. Finally the court takes it under consideration and if a new trial is granted it must be tried again in the original court. In most states there may be indefinite appeals until the case has reached the court of last resort, been decided there on the last technicality, and a rehearing has been asked for and refused. There is always delay between appeals, and it is entirely possible for a lawsuit to go on for years and become an heirloom, which is handed on from generation to generation. It will be seen

that the person or the corporation with the longest purse has a great advantage. Such a one can employ more experienced and abler counsel and can stand the mounting costs better than the person who has nothing but a just cause.

Attempts have been made from time to time to simplify procedure and to make litigation less costly and less dilatory, but so far without any great measure of success. To laymen both courts and counsel often appear much more concerned in observing the rules of the game than in administering justice as between man and man. As stated in one of our legal periodicals: ¹

While every other profession has been practically made over in the past twenty-five years, the conservatism of the legal profession has stood in the way of substantial changes in the rules of procedure and practice.

Elihu Root, in the foreword to "Justice and the Poor" states:

We have had in the main just laws and honest courts to which people—poor as well as rich—could repair to obtain justice. But the rapid growth of great cities, the enormous masses of immigrants (many of them ignorant of our language), and the greatly increased complications of life have created conditions under which the provisions for obtaining justice which were formerly sufficient are sufficient no longer. I think the true criticism which we should make upon our own conduct is that we have been so busy about our individual affairs that we have been slow to appreciate the changes of conditions which to so great an extent have put justice beyond the reach of the poor.

Ex-President Taft, in an address before the Virginia Bar Association, said:

Of all the questions which are before the American people, I regard no one as more important than the improve-

¹ *Case & Comment* for July, 1917.

ment of the administration of justice. We must make it so that the poor man will have as nearly as possible an equal opportunity in litigating as the rich man, and under present conditions, ashamed as we may be of it, this is not the fact.

Note:

1. Before becoming involved in litigation reckon the cost, to the limit of the last appeal.

§ 31. Advisability of Litigation

There are circumstances under which it is necessary to go to law, and then its advisability is not open to discussion. Such circumstances may be compared with cases in which surgical operations have become imperative. The only question then is to be sure that you secure a skilful attorney to represent you. But many cases arise where there is strong temptation to bring suit, but where it might be more prudent to compromise or settle by other means. What follows applies to these debatable cases.

When you feel that you have been wronged and consult a lawyer, you want him to sympathize with you, to assure you of the merits of your case, and to advise you to show the other party that he cannot ride rough-shod over you. This is the lawyer's selling talk that you expect. You tell him to go ahead and cheerfully give him a check for a few hundred, which he says will be plenty to keep things moving until the case comes to trial.

If instead, he tells you judicially that, while you have a good case, it will save time and money to compromise in some way rather than to litigate, you take it as an unfriendly act, grudge him his modest fee for saving you a lawsuit, and tell your friends that he is too cautious ever to make much at the bar. Next time you have trouble you think you will find a lawyer with a little more "sand."

Lawyers know that most men who consult them feel this

way. As one lawyer expressed himself, it is easier to get a \$1,000 fee for trying a case than \$100 for effecting a compromise. Therefore do not expect that your lawyer is going to punish himself to do you an unwelcome service. You can try this plan:

Ask your lawyer to make you an estimate of what the case will be likely to cost in counsel fees, preparation for trial, court costs, and incidentals. Then inquire as to what amount of your time will be required for consultation, attendance on trial, waiting for the case to be called, etc. Estimate what your time is worth in your business and add to the previous amount. Estimate how much thought and worry you will put into it and how much this will detract from your business efficiency. Assume you get judgment in your favor and the case is not appealed. How does the account stand?

You may have a good case and still lose out. Such things have happened. Appeals are possibilities. There is a chance of heavy costs and fees. Consider all eventualities before you decide on your course.

Notes:

1. Prevention is better than cure. "Beware of entrance to a quarrel."
2. Calculate your costs in advance. This discourages litigation.
3. Tell your lawyer you would rather pay him to keep you out of litigation than to win your case. If he is young at the business he may take you at your word.

SUGGESTIONS TO READERS

If possible, attend the trial of a *civil case* before a magistrate. This is the court where suits for small sums are brought; its processes are simple and rapid. But its procedure is typical. Note the function

of the magistrate, the counsel, the constable, marshal, or other officer of the court. Note how witnesses are called, sworn, examined, cross-examined. Note the arguments of counsel. Then answer these questions:

1. After hearing the witnesses, how would you have decided the case?
2. After hearing the lawyers argue, would you have decided otherwise?
3. Was the actual decision just?
4. Allowing fair rates of payment for the time of the men engaged in the trial, for the judge, constable, parties, lawyers, and witnesses, how much did the trial cost the community? What was the amount involved in the litigation?
5. Was the suit a fair average as to time, amount involved, number in attendance, etc?
6. Could you devise any better system for settling disputes?

REVIEW QUESTIONS

1. Why is legal process to redress a wrong usually unsatisfactory?
2. What is the distinction between "law" and "equity"?
3. In your state are there separate courts of law and equity?
4. Can suit be brought against a person without giving him notice?
5. What is the object of the procedure in a suit before trial?
6. What defects are there in trial by jury?
7. If you were party to a suit, would you rather have it decided by a jury or by a judge? Why?
8. If a party fails to get a verdict or decision can he bring a new suit?
9. What could be done to make justice cost less in time and money? Can you suggest any method of judicial reform?
10. Should a lawyer advise litigation or compromise? What circumstances should influence his advice?

CHAPTER V

CRIMINAL LAW

§ 32. Criminal Procedure

Criminal law is administered in a manner different from the usual procedure at law and in equity. The state prosecutes for crime, and, while the accused person is called the defendant, there is no plaintiff save the state. The designation of a criminal case might be: "State of Ohio v. John Doe (name of accused)." In the different states there is more or less variation in the administration of criminal law.

Criminal prosecutions are usually instituted by a warrant sworn to by the aggrieved party before a magistrate. The magistrate then summons the accused person to appear or issues a warrant for his arrest. In minor cases the magistrate tries the person, or in some instances the accused may demand a trial by jury. Where the offense is serious, the magistrate has only jurisdiction to commit the accused to await the action of the grand jury. In most cases the accused person is allowed to give bail to insure his appearance when the grand jury meets.

Serious crimes must always be prosecuted by indictment; i.e., a written accusation authorized by a grand jury. The grand jury consists of eighteen or more men and is convened from time to time in each county to investigate any charges of crime that may be brought before it. Proceedings before a grand jury are, of course, *ex parte*, i.e., only one side is heard. These proceedings are under the supervision of the legal representative of the state, the prosecuting attorney. The object of the grand jury investigation is to ascertain what

persons should be tried before a trial jury and whether the evidence against people accused of crime is sufficient to justify the state in prosecuting them. If an indictment is found and the person has not been arrested, the authorities try to arrest him. The names of all who are indicted are placed on a criminal docket to await trial before a trial jury. The grand jury system is painfully cumbrous.

In darker ages the criminal law was so often used as an instrument of oppression and for the punishment of political offenders and the criminal laws were so cruel, that popular sympathy was with the man accused of crime and gradually he was given various rights and privileges to even up his unequal contention with the powers of the state. It is not unlikely that this process has gone too far.

In many states criminal procedure has become so complex and so overridden with technicalities that any criminal who can afford to pay skilful counsel may escape all penalty except the large payments he makes to his own lawyers. The difficulty of convicting a wealthy criminal is the scandal of our legal administration of justice.

On the other hand, the criminal law as it exists is incredibly unjust to the poor and ignorant. A widow with a dependent family started to sell fish in New York and failed to cover them over to protect them from the flies. She was arrested and fined two dollars. She did not have so much and was sent to jail for a short term, leaving her family of young children unattended.¹

If a wealthy young man is arrested for speeding, he is released on his own recognizance or a deposit of cash. The next day he is fined twenty-five dollars, promptly writes a check and walks away. Meanwhile we marvel at the growth of anarchistic thought!

¹ *Scribner's Magazine*, July, 1919. Page 115.

§ 33. Classes of Offenses Against the Criminal Law

It is well to know that offenses against the criminal law are divided into two classes: felonies and misdemeanors, according to the degree of the offense.

A felony is a grave offense, punishable by heavy penalties. A misdemeanor is a lighter breach of the law and is punishable by lesser penalties.

Burglary—the breaking into a dwelling house after dark with criminal intent—is a felony and is punished by confinement in a penitentiary. Driving an automobile too fast is a misdemeanor and may be punished by a fine or confinement in the county jail.

Criminal offenses are also divided on another basis into two classes: those which are wrong in themselves and those which are wrong merely because the law prohibits them. In order to make this distinction easier to keep in mind, lawyers use the Latin terms “*malum in se*” (wrong in itself) and “*malum prohibitum*” (wrong because it is prohibited). At the present time there are a great many naturally indifferent actions which have been made into crimes by the procedure of the legislature, and there is such a multitude of these laws that it is very hard for anyone even with the best intentions to avoid violation of the law at some time.

§ 34. Penalties

The penalties for violation of the criminal law are fines, imprisonment, and, for a few offenses, death. In this country the Constitution of the United States prohibits banishment and forbids cruel and unusual punishments.

In no direction is there greater room for reform than in our treatment of criminals. Many of these are as they are by reason of environment and lack of training. Others are mental defectives who should be humanely kept from temptations they cannot withstand. It may safely be said that our

criminal law as it is generally administered does not prevent crime, reform the criminal, or deter others from crime.

The most dangerous and vicious criminals are those who are intelligent and educated and use these advantages to keep clear of the clutches of the law, while they do things that in effect injure their fellows far more than all the burglars and murderers in the country. These are the "malefactors of great wealth" that roused Roosevelt's honest wrath. The criminal law always lags behind, and enactments to check the crimes of such as these unfortunately catch only their clumsy imitators.

REVIEW QUESTIONS

1. Who is the plaintiff in a criminal case? Why?
2. What is the function of a grand jury?
3. Can you suggest any method of improving the administration of our criminal law?
4. If a certain action, harmless of itself, has been made a crime, does it thereby become morally wrong?
5. If a man is willing to pay the penalty, say for speeding, does that justify him in disregarding the law?
6. What are the two classes of offenses against the criminal law? Give an example of each.
7. Outline the usual criminal procedure.
8. What is the primary object of legal penalties for crime: (1) retaliation, (2) protection of the community, or (3) the reformation of the criminal? What *should* be the object, or objects of the criminal law?
9. Which are the greater deterrents of crime—severe penalties, or more moderate punishments? Why?

PART II
CONTRACTS

CHAPTER VI

ESSENTIAL FEATURES OF A CONTRACT¹

§ 35. Introductory

Civilized life may be said to be founded on agreements. Whenever an individual buys or sells something, he makes an agreement. Our whole social and business life is based upon a series of understandings with those with whom we come in contact. The more complex our civilization becomes, the more agreements are made and the more extended become our contractual relations.

Whenever an agreement is of such a nature that it may be enforced in a court of law, it is called a contract. Most of the laws on our statute books and most of the laws affecting the daily life of the individual have to do with the subject of contracts. The sale of goods is a contract, the appointment of an agent is a contract, and the business done by an agent is that of making contracts. Insurance, whether of life or of property, is a contract; partnerships and corporations are both based on contracts; in fact, there is no business relation but is either itself a contract or else is based upon a contract.

§ 36. Definition

A contract is defined as an agreement between two or more parties, for a sufficient consideration, to do or not to do some specified thing or things. This is the accepted legal definition of a contract.

¹ For forms of contracts, see Chapters XCVIII-CI, Forms 1-25.

It is an agreement, and the minds of the parties, to use the technical phrase, "must meet."

There must be *two* legally competent parties to a contract; there may be many.

There must be a consideration, without which there can be no legal obligation. If a man agrees to do something, there must be a valid reason or inducement for him to bind himself. This, in legal parlance, is the consideration. If the promise were gratuitous, that is, if there were no inducement for the promise, it might be a matter of honor to carry it out, but it would not be a matter of legal compulsion. A naked promise, without consideration, cannot be enforced in a court of law.

There must be the obligation, or thing to be done. This promise may be to pay money, to do work, or to deliver goods; or it may be merely not to do something which the person contracting had a right to do.

§ 37. Essential Features

In order to make any agreement legally enforceable as a contract, there must be the following essentials:

1. The parties to the agreement must be legally competent to contract.
2. The agreement must be to do something lawful.
3. The parties must agree to the same thing.
4. There must be a sufficient consideration.

These several elements of a contract will be explained in the following sections.

§ 38. Competency of Parties

The parties to a contract may be individuals, partnerships, or corporations. The partnership name may be different from

the names of the partners composing it. The laws of most states provide that one or more persons may associate themselves under any name they choose to assume for business purposes, and upon recording it in the proper offices together with their own names and addresses may do business and contract under the assumed name.

A person would bind himself if he contracted under an assumed name. The other party might not be bound, if he was deceived.

Generally all persons are able to bind themselves by contract. It is a positive right. But there are exceptions to the general rule. Certain persons are not competent to contract, and certain other persons have only a qualified right to make contracts.

If a person has been legally declared a lunatic or a spendthrift, and a guardian has been appointed by the court to look after his property, such person has no power to enter into a binding contract. No agreement made by him could be enforced, even though the person dealing with him did not know that he was insane or a spendthrift and had been legally declared incompetent. There is one exception to this rule—a contract to buy absolute necessities for life and health. A person may supply an insane person with necessary things and will be legally entitled to payment for them.

As it is necessary for a party to give his free consent to an agreement and to know what he is consenting to, intoxicated and insane persons who have not been legally declared to be such, cannot make enforceable contracts if the insanity or the intoxication prevents them from understanding the nature of their acts at the time the contract is entered into.

The Law Varies with Location. This question of competency depends on the law of the place where the contract was made. If a person legally declared a spendthrift should go into another state, he would be perfectly capable of making

contracts there until he has been declared a spendthrift in the courts of that state. A person legally declared insane, if he had lucid intervals, might in a state other than that in which he had been declared insane make an enforceable contract in a lucid interval. The age at which a person becomes legally competent to contract varies in different states. The local law should always be consulted.

Indians. Indians living on government reservations are protected by the federal law, and may make enforceable contracts only under such conditions as that law prescribes. If they leave the reservations and enter into ordinary business relations, they are usually held liable in the same way as any other business men.

Married Women. A married woman does not have entire freedom of contract. As a usual rule a married woman cannot make an enforceable contract with her husband. Formerly a married woman could not make a contract at all without her husband's consent, but this has been changed. It is safest to consult the law of the state in which one resides before entering into a contract with a married woman, as a few states still give her a measure of irresponsibility. A married woman may, in any state, act as an agent for her husband. (See § 128.)

Minors. Minors (persons who are under legal age, which is generally 21) have only a qualified ability to make contracts. That is to say, the minor may make a contract but the other contracting party cannot enforce it if the minor chooses not to perform his part. The minor may even annul the contract after it has been performed, return the property and demand his money back, or vice versa. If the minor has taken a fraudulent advantage of the other person by leading that person to think he is of full age, the law will later prevent the minor from stating that he is under age when he comes into court, and will therefore make him perform

his agreement. If under the contract the minor has received property or money from the other party, he will be made to repay or to return it if possible; but if he has spent or otherwise disposed of it he may, as a rule, still refuse to repay or return it.

People dealing with young persons are supposed to look out for their own interests and to find out whether such parties are of age or not. The minor, because of his inexperience, is guarded by the law not only against the designs of other persons but also against his own carelessness. He is not, however, guarded against his own wrong-doing. If he injures property he will be obliged to pay damages.

After a minor has come of age he may confirm any contracts made while he was a minor. He may do this either by words or by acts. If he keeps the property obtained under such a contract for an unreasonable length of time, however, the court will consider that he has confirmed it. Moreover, unless the minor pleads his infancy in court, a contract may be enforced against him as against any other person. No one else may plead this for him. If he becomes insolvent, a receiver of his property may not call off any of his contracts for him, no matter how unfair. If the minor himself chooses to stand by them, they are legally binding.

Note:

- I. It is not safe to have any business dealings with a minor.

§ 39. The Subject Matter Must Be Lawful

The subject matter of a contract is that which the agreement is about. It may consist of any property, commodity, or service which could be the subject of a business transaction, or it may be to do or not to do something, such as to pay for the privilege of naming a child, or to pay a young man to abstain from using tobacco.

An agreement to do anything contrary to law would be unenforceable. An agreement to do anything which, while not directly contrary to any special statute, would be injurious to the peace and good order, the health, or the morals of the community, would be against public policy and would be unenforceable.

The following agreements would be contrary to law or to public policy and therefore unlawful:

1. An agreement to prevent a person from marrying or to break up a marriage.

2. An agreement to persuade one person to marry another.

3. An agreement in restraint of trade. The Supreme Court has decided that agreements in *reasonable* restraint of trade are not contrary to public policy. Where a person sells out his business to another he may agree not to engage in that business again within certain reasonable territorial limits and for a limited time, but the majority of the cases in this country condemn contracts to restrain trade throughout the entire state or in the entire country for an indefinite period. It is considered to be against public policy that the people of the whole state should for any length of time be deprived of the industry and skill of anyone engaged in a useful employment.

4. Gambling contracts. Contracts for the buying and selling of "options" and "futures" and of stock "on margin," are regarded as gambling contracts in some states, and will not be enforced unless the party selling the stock was in some way entitled to it or was selling it as agent for the real owner.

Fire insurance can be taken out on property only by a party who has some interest in it, and life insurance only by the party insured, his wife, child, or some other person who would be entitled to support, or by a creditor who had a claim against the person whose life was insured, or by a

business partner or employer. Otherwise it would merely amount to a wager as to whether the property would be destroyed or when the person would die.

5. Contracts in which usurious interest is charged. Sometimes the contract itself will be enforced, but the party will be prevented from collecting interest; sometimes he will not be allowed to enforce any part of the contract.

6. Contracts to commit a fraud or a crime.

7. Contracts for the sale of adulterated goods.

8. Contracts to bribe public officials, or contracts of bribery with such officials.

9. Agreements by candidates to appoint persons to positions in case said candidates are elected, or to do anything else in return for aid in securing their election.

10. Agreements not to prosecute a person for a crime.

All of these last cases are contrary to public policy because the subject matter pertains to something unlawful and injurious to the community.

11. An agreement made in advance not to take a dispute into court. The law favors the settling of disputes out of court as much as possible; but it is contrary to public policy to deprive any man in advance of his right to be heard in court whether by agreement or otherwise. But, while two parties may not contract to refrain from taking a possible disagreement to court, they may contract to arbitrate in a specified manner before the court is resorted to.

12. A contract to perform services in return for money made by a medical student before he has been licensed, by a law student before he has been admitted to the bar, or by any other person who is required by the law to submit to certain requirements before being licensed to practice his profession or vocation and who is not yet so licensed, is void; any fees which may have been agreed upon cannot be collected.

When an illegal contract has been made, the courts will

refuse to interfere at all. The parties are simply left as they are, to straighten the matter out as best they can.

Notes:

1. A contract to do anything unlawful cannot be enforced.
2. No money paid on such a contract can be recovered.
3. No services so rendered can be made the basis of a suit.

§ 40. The Law of Place

The law which governs a contract is the law of the place where it was made. If it is to be performed elsewhere, the parties may, if they wish, expressly state that it is made in conformity with the law of the state where it is to be *performed*, provided they do not do so in an attempt to evade the law of the state where it was made. A contract made in good faith to be performed elsewhere need not comply with the law of the state where it was made if there is a conflict between the two laws, but the fact that it is to be governed by the law of a state other than that in which it was made must always be expressly stated in the contract. (See also § 38.)

§ 41. The Subject Matter Must Exist

There must be some subject matter in existence to contract about. If the contract were to add a wing to a house and the house were burned down at the time of the agreement without the knowledge of the contracting parties, there would be no contract. If, however, the contract was about something that has been lost or destroyed but that might be replaced, such as a contract for the sale of grain, the contract is valid and the party who agreed to deliver the grain must procure it elsewhere. (See also § 88.)

§ 42. Agreement of the Parties

It is essential that the parties to a contract agree on the terms; or, in legal phraseology, that "their minds meet." This agreement results usually from an offer made by one party which is accepted by the other. The offer or proposal may be oral or written, and the acceptance may be oral or written. The simplest form of contract is an offer to sell goods at a specified price and an acceptance of the goods at that price. If this offer is made by letter and the acceptance is made by letter, the two letters taken together constitute a complete contract of sale. Some other points might be mentioned, but these the law will supply. When nothing is said as to terms, the law implies cash. When nothing is said about delivery, the law implies that the buyer will be entitled to delivery when he pays the price. (See Chapter XVI.)

Acceptance by Mail or Telegraph. If the party making the offer requests an answer by mail or telegraph, the post-office or the telegraph company becomes his agent to receive the acceptance, and the agreement becomes effective the moment a properly stamped and addressed letter of acceptance is deposited in the mail-box (even though the letter does not reach its destination) or the moment a prepaid telegram (unless the other party had directed that it be sent "collect") with the proper address, is given to the telegraph company to be sent.

The point is important because the person making the offer has a right to withdraw it if he informs the other party of his change of decision before the other party has accepted, i.e., has put a letter in the mail or has sent a telegram of acceptance. In other words, a contract may be complete *before* the acceptance is actually received, and it is then too late to withdraw the offer.

If a party makes an offer by mail or telegraph, he is regarded as having requested a reply by the same means

unless he expressly asks for a reply in some other way; so that if the party receiving the offer replies in the same way, his acceptance becomes effective from the moment he mails it or gives it to the telegraph company to send. If, on the contrary, he replies in some other way, there is no agreement *until the answer actually reaches the other party*. In this last case, if the first party sends a letter withdrawing the offer and this letter arrives at its destination before the letter of acceptance reaches the first party, there is no agreement.

Manner of Acceptance. The offer must be accepted in accordance with its terms. To accept an offer in any terms other than those in which it was made amounts to a refusal. The first party may decide to accept the new terms, in which case there will be a new and different agreement, but he has the privilege of rejecting the proposed contract entirely. If the offer was made to one person only, another could not accept it; if made for a limited time, it must be accepted within that time. Advertisements offering a reward for the return of lost articles are made to the public in general and the offer may be accepted by anyone who finds the goods. An offer cannot be accepted, however, after the party who made it dies or becomes insane, and it must in any case be accepted within a reasonable time; people cannot be held to offers made long ago and forgotten, or after the circumstances which led to the offers have changed. What constitutes a reasonable time will depend on the circumstances. The party who makes the offer may set a time limit for its acceptance, after the expiration of which the offer is no longer open for acceptance. It is always prudent to accept a desirable offer promptly.

Options. In negotiations an option or refusal may be given, good for a certain time. Unless something has been paid for an option, it may be revoked at any time because it is an agreement without consideration. An option so given

is a contingent offer and may be accepted at any time before withdrawal or expiration of time.

§ 43. Oral Agreement

In many cases of contract the parties agree upon the terms orally by discussion, proposal and counter-proposal, suggestion and objection, until they think that they have arrived at substantial agreement. At this stage the contract should be reduced to writing. When this is attempted it will usually develop that each party has understood the discussion differently and a renewed discussion results. Finally, when the written agreement is agreed to by both, it is signed; and then it supersedes all understandings and binds the parties.

In most cases an oral contract is as good as a written one except that it is harder to prove. After a discussion of terms each party has a different impression of the conclusions reached. Certain parts deemed favorable by one party are most strongly impressed upon his memory, while other parts not so agreeable are not so well remembered, and after a year or so two men can honestly go into court and swear to absolutely contradictory accounts of the same transaction. Here the great advantage of the written agreement becomes apparent. That which is written changes not; and the law will not allow oral evidence to be introduced to contradict that which the parties have agreed to in writing. If, meanwhile, one of the parties has died, the written contract is yet more essential for proof. Hence, in business, one should never entrust to memory anything that can possibly be put into writing. (See §§ 46, 47.)

Notes:

1. In most disputes over contracts, the trouble arises because part or all of the contract is not written.
2. On this account the exchange of letters makes for certainty in contracts.

§ 44. Consideration

A promise to do something or to give something is not a contract, since a mere promise cannot be enforced by law. There must be a consideration for the promise; the consideration being something done, given, or promised by the other party.

One party's promise is a good consideration for the promise of another party. If A agrees to pay B for a certain service and B agrees to perform such service, a valid contract has been created and A must fulfil his promise when B has fulfilled his. Or if A promises to pay B for goods delivered to C, when B has made delivery A must pay him.

Mutual Promises as Consideration. If a person makes a promise in return for another person's promise, the law will require him to make good his promise when the first party has fulfilled his. In other words, mutual promises are consideration for each other. An example may be found in an ordinary real estate contract wherein one party promises to sell and the other party promises to buy. The consideration for an enforceable contract may be very small compared with the value of what is agreed to by the other party; it may be inadequate or even insignificant.

For instance, a man might offer to give his son \$1,000 if he would refrain from smoking until he was twenty-one. It would seem that the son gives very little in return for the money, but he is giving up the right to smoke—and the contract will be enforced. In this case, the consideration for the \$1,000 is the surrender of a privilege.

It is very common to mention the sum of \$1 in contracts where the parties do not wish the real amount of the consideration to be known. In most cases one dollar named will be held a sufficient consideration. "A valuable consideration, however small or nominal, if given or stipulated for in good faith, in the absence of fraud, is sufficient to support an action.

A stipulation in consideration of one dollar is quite as effectual and valuable a consideration, as the larger sum stipulated and paid.”²

Impossible Consideration. If the consideration agreed to by one of the parties is something impossible to perform, the contract is void and unenforceable. This would be true if one of the parties agreed to do an illegal act in return for the other party’s promise. He could not be required to perform it; consequently he has given nothing.

Doing something that one is already obliged by law to do is not a valid consideration; for instance, a promise to pay a debt already owed would not be a good consideration for a new agreement. An agreement to pay half of a debt due in full settlement would not be any consideration for the other half which the law would still hold to be a binding debt. (See § 500.)

Love and affection for one’s friends and relatives do not constitute a legal consideration for a contract. One does not love them more or less on account of the agreement. There is no change in the situation of the person which would make it necessary for the law to interfere to compel the other party to keep his promise.

Notes:

1. Some consideration should always be mentioned in the contract.
2. It is wiser to name the true consideration, as then there can be no misunderstanding if it becomes necessary to prove the contract in court.
3. The matter of no consideration comes up again and again in legal practice, making void otherwise good agreements, and the principle should be thoroughly comprehended.

² *Lawrence v. McCalmont, 2 Howard (U. S.) 426.*

REVIEW QUESTIONS

1. What are some common synonyms for the word "contract"? When does the word "contract" apply? Why is the law of contracts of wide application?
2. What is the legal definition of a contract?
3. Name and number the essential elements of a contract. What does the word "consideration" mean as an element in a contract? Give an example of a negative obligation in a contract.
4. Who are competent to make contracts? Who are not competent to make contracts? If a person not competent to make a contract signed an agreement, what would be the effect? May a person contract under any name he may assume?
5. What is the law as to a married woman's contract in the state in which you live? ^a
6. What is the effect when a minor makes a contract?
7. What is the legal age of majority in your state?
8. If a minor represents himself as of age, what is the effect?
9. If a minor bought a motorcycle, could he keep it and refuse to pay for it? Suppose he had wrecked it?
10. When may a creditor enforce a contract against a minor?
11. Can a minor enter into a binding contract of marriage? Why this exception?
12. What is the object of a minor's disabilities? Why is it unsafe to deal with a minor?
13. What two classes of contracts are unenforceable? What agreements about marriage are unenforceable?
14. What is the rule as to "agreements in restraint of trade"?
15. What are "wagering contracts"?
16. What is the law as to usury in your state?
17. What other agreements are illegal?
18. What does *lex loci* mean? Is a contract affected by the law of the place where it is made? A contract executed and delivered in California is the subject of a suit in New York.

^a Where questions as to local statutes are given, a note should be made and the matter should be looked up later. The statutes of the state may be consulted in some public library and the answer written after the question; a legal friend may be questioned; a letter may be written to an editor who has a query department.

There are forty-eight different states and in a book of general information it is not feasible to give the varying statutes of each state, but it is of advantage to the reader to look up the particular information as to his own state and write this out where it can be found when wanted.

What laws govern the validity and construction of the contract? What laws govern the remedy?

19. What is the rule as to existence of the subject matter? If a sale were made of a particular horse at another place and the horse had died before the contract was made, what would be the effect? Suppose the purchaser had paid for it?
20. What terms as to payment are implied in a contract? As to delivery?
21. When do the minds of the parties meet in a contract made by mail or telegraph? What is the rule as to the method of acceptance?
22. A writes and offers goods to B, in another town, at a stated price. B receives the offer and immediately writes back to A his acceptance. The letter is deposited in the mail-box but never reaches A. A, not hearing from B, offers his goods to C, whose acceptance reaches A. B sues A for breach of contract. Has he a cause of action? Why?
23. A, on March 21, wrote B, a day's journey away, and offered B a position. He ended his letter by saying: "You will confer a favor by giving me your answer by return mail." B received the letter on March 22. B on the 23d wrote her acceptance and gave it to a boy to mail. The postmark showed that it was not mailed until the 25th. A not receiving answer offered position to another. B sued for breach of contract. Has she a cause of action?
24. What is the effect of accepting with a slight variation of terms? How long does an offer stand open?
25. Why is a written contract better than an oral contract? Why should the terms of an agreement be definite?
26. Why cannot an agreement without consideration be enforced?
27. If a man owes \$100 and agrees to pay \$50 in discharge of the debt, can he be made to pay the remainder? Why?
28. Without other consideration is payment of a smaller sum ever satisfaction for a debt of greater amount?

CHAPTER VII

HOW CONTRACTS ARE MADE

§ 45. Classification of Contracts

In this book contracts have been classified according to function, into contracts of sale, contracts of agency, etc. Certain other more arbitrary classifications of contracts, though only occasionally referred to in practice, are frequently the subject of examination questions. For this reason these classifications are explained in the present chapter.

Some of the terms are logically objectionable, but those who submit themselves to examination fare better if they give the required conventional answers than if they follow the rules of logic. For example, a common question is: What are contracts of record? Part of the required answer is: Judgments and recognizances. As a matter of fact neither a judgment nor a recognizance is a contract according to the legal definition. The parties' minds do not meet, and there is no agreement. Nevertheless the text-books call these court entries "contracts of record."

Another common question is: What is a simple contract? and the answer expected is: A contract not of record or under seal. In fact, the word simple means the opposite of compound, complex or intricate and in many cases the so-called simple contracts are more complex and abstruse than a contract under seal such as, for example, a quitclaim deed, than which no contract could be simpler. The seal, the witnesses, the notarial acknowledgment, the filing or recording of a contract in an office of registry are all matters intended to evidence the contract. They do not make it complex or affect its

character in any way. Nevertheless, those who are preparing for examination must know how to answer questions of this sort upon occasion.

Contracts, then, may be classified in regard to dignity and facility of proof as follows: (1) oral contracts, (2) written contracts not under seal or of record, (3) contracts under seal, and (4) contracts of record.

All contracts not under seal or of record are called simple or parol contracts whether in writing or not.

Formal contracts are contracts of record, bonds and recognizances, and contracts under seal, which include all deeds and instruments affecting land that are required to be recorded in offices of public registry.

§ 46. Oral Contracts

A contract may be made simply by word of mouth or by words and acts. Such a contract is called an oral contract. If it becomes necessary to go into court in order to enforce it, it will be necessary to prove it by oral testimony. The parties to it will be called on to testify as to what was said and done, and if any other people were present either party may call them as witnesses.

In such a case the difficulty is that the agreement has not been reduced to writing and the various parties present probably have entirely different ideas as to the meaning of what they heard. The court may decide that the testimony as to what happened is so vague and contradictory that it cannot be enforced as a contract. The prudent business man will insist that all agreements be made in writing and properly signed, in order that there may be no question as to just what obligations he has assumed or what he may properly expect from the other party to the contract. Some contracts must be in writing or the courts will refuse to enforce them. (See § 48.)

Notes:

1. Avoid oral contracts.
2. Have all contracts written and signed by the parties thereto.

§ 47. Written Contracts

The written contract need not be a formal document. Two letters, one making a proposition and the other accepting it, constitute a contract just as much as a legal document duly signed and sealed and acknowledged before a notary.

The written contract should contain all the terms—the names of the parties; a statement of the consideration, with the time and the method in which it is to be paid or performed; a clear statement of just what is agreed upon, when it is to be done, and in what manner; together with any arrangements the parties wish to make if something happens to render the contract impossible of performance, or in case it is only to be performed under specified conditions. (See Chapter XCVIII, "Drafting a Contract.")

Business men are accustomed to expressing themselves clearly, concisely, and explicitly in their letters. Letters and copies are always carefully filed and preserved. For this reason when legal assistance is dispensed with, a letter from the party making the offer and a reply from the party accepting or rejecting it are usually the most satisfactory method of securing a written contract. Each party has his own records. Since they are accustomed to expressing themselves by letter, they understand what they have agreed to better than if the terms were expressed in formal, legal phraseology. Even if a lawyer is called in later, the exchange of letters is a good way of making an agreement. If there is an extended correspondence before the parties finally arrive at an agreement, the last letter should sum up all the terms on which

they have finally agreed, and this should be answered by a simple letter of acceptance, repeating the terms as therein stated. (See Chapter C, Forms 13, 14.)

Note:

1. Write all contracts. Never trust to an oral understanding.

§ 48. The Statute of Frauds

In order to do away with the uncertainty of relying on people's memories in contracts by word of mouth, there was passed in England in 1676, a law called the Statute of Frauds, which required certain contracts to be in writing. This statute has been copied into the law of most of the states of the Union.

The Statute of Frauds requires that the contract *shall be proved* by some memorandum in writing. It is not necessary to make the memorandum at the time the contract is agreed upon. If any memorandum or letter containing the essential terms of the contract, i.e., the names of the parties, the consideration, and enough to show the nature of the agreement, and signed by the party to be held, is written at any time before the other party comes into court to enforce the contract, the requirements of the law are satisfied.

Form of the Memorandum. The memorandum must be signed by the party against whom it is to be enforced, or he will not be liable under it. It need not be signed by the other party. Under the law as enacted in some states, this signature must be at the end; in others it is sufficient if it is put in any part of the memorandum with the intention of signing. This written memorandum need not be one paper; it may be written on two or three sheets if all refer to each other plainly and together make a complete memorandum of the terms of the contract. At an auction or a sheriff's sale, the auctioneer or

the sheriff is the agent for both of the parties and may sign a memorandum for either of them.

Contracts Which Must Be in Writing. The following contracts must be proved by a written memorandum:

1. A contract where the consideration is marriage.
2. The promise of an executor or an administrator to pay a claim against an estate which is in his charge out of his own money. If any property of the estate is left, the claim will be payable out of that, but in any case the executor or the administrator will not be liable personally unless there is a written agreement.
3. A promise to be responsible for the debt, the default, or the miscarriage of another. This means a contract of suretyship or guaranty, which will be explained later. (See Part XIII, "Suretyship.")
4. A contract for the sale of land or of any interest in land. This does not refer to a deed, but to a contract to give a deed. A deed must always be in writing. A deed which is not in proper form to operate as a deed may sometimes operate as a contract to sell the property, and the party will be compelled to give a good deed. A defective deed cannot be corrected without much trouble.

If a person makes a contract to sell or to buy land through an agent, the agent must in most states be given authority in writing to sign the contract.

Growing things, such as trees, grass, and plants that come up of themselves every year are regarded as part of the land, and a contract to sell or to buy them must be in writing. Crops which have to be planted every year are not regarded as part of the land even while they are growing.

A lease of real property, if it is to last for over a year, must usually be in writing.

5. A contract which is not to be performed within a year from the time it was made. A contract which might possibly

be performed in a year, although it might take longer, need not be in writing to be enforceable. It is always better, however, to have such a contract in writing.

6. A contract for the sale of personal property of over a certain fixed amount in value. (This is explained fully in Chapter XVII, "The Statute of Frauds.")

Note:

1. The fact that an oral contract may be unenforceable because of the Statute of Frauds is another reason why all contracts should be in writing.

§ 49. Contracts Under Seal

The use of the seal is a survival from the time when very few people could read or write. The seal was used on the most important documents as we use a signature today. Because of the importance that was attached to it then, the seal is still used on documents of the greatest importance.

Deeds and mortgages of land, and in some states wills, must be under seal. A power of attorney to deed land also requires a seal. A seal on any document, such as a deed or a contract, is regarded as showing that there was consideration for the deed or the agreement whether any is mentioned in the document itself or not. In this country, however, a person is usually allowed to prove that there was no consideration, even if there is a seal.

A seal may in many states be merely a scroll. In others a little red wafer is used. In New York the letters L.S. (*locus sigilli*, the place of the seal) which were originally intended as instructions as to where the seal should be placed, are now regarded as a sufficient seal.

A corporation generally verifies papers, particularly important documents, with its corporate seal.

A contract under seal is also called a contract by specialty.

The word "covenant" is applied as follows: (1) It may be a written agreement under seal; (2) It may be a modifying agreement contained within a deed or other sealed instrument; (3) It may be a clause of an agreement contained in a sealed instrument.

Note:

1. Seals are generally required in connection with legal papers dealing with real estate, on bonds, and sometimes on wills.

§ 50. Contracts of Record

Contracts may be distinguished as to whether or not they are of public record; that is, filed or recorded in some court or public office. The highest form of contract of record would be a judgment, which may be called a contract of record although it lacks any element of a contract. It may be founded upon a contract, but when a judgment has been secured so that it is of record, it becomes a claim that can be collected at any time at the option of the party in whose favor it has been rendered.

Another form of contract of record is what is called a recognizance. In certain legal procedures a party is required to give bond or furnish surety that he will appear before the court at a certain time or that he will keep the peace, observe the terms of an injunction, or do some other thing. Though this is a compulsory proceeding, and has no single trace of an agreement or a consideration, it is nevertheless called a contract of record.

Other contracts of record are deeds, mortgages, contracts to convey land, or other instruments which, after being acknowledged before a notary public, are filed or recorded in the office of registry for record for the particular locality. Acknowledgment is a prerequisite to registration. (See

Chapter XCIX.) These have been referred to already as contracts under seal because most of them are evidenced by a seal.

§ 51. Express and Implied Contracts

An express contract is a contract the terms of which have been spoken or written and agreed to by both parties. It is called an express contract in contradistinction to implied contracts which arise by inference and not from express words.

An implied contract is a contract that arises where no promise has been expressed. If a man orders goods from a dealer it is implied that he means to pay for them, not any price that the dealer might charge, but at their reasonable value. It is not necessary that he should promise to pay for the goods. If he orders them the promise to pay is implied or understood.

If one person accepts the benefit of another's services, the law holds that a contract to pay for them at what they are reasonably worth is implied, and the person who performs the service may claim compensation in court.

The same reasoning holds if a person occupies land, buildings, or rooms. The law implies a promise to pay a reasonable rent. If two people have a running account with each other, the law considers that they have promised each other that the one from whom a balance is found to be due shall pay that balance to the other. The promise to pay is based on the fact that the party has willingly taken the benefit of what was done. If something was done for him without his making any request, and without his afterwards making any use of it, he could not be charged for it.

If, without orders, a man left bread at your door every morning, and you used it, the law would imply a promise on your part to pay for the bread. If he put a new roof on your house in your absence without orders, he could not collect for

it, because you would have to use the new roof whether you desired such repair or not. In case the person who performed the service intended to do it without claiming payment for it, it would be a gift and there would be no implied contract to pay for it.

Note:

1. It is always most satisfactory to have a distinct understanding as to prices for services rendered. Even lawyers, dentists, and plumbers are sometimes believed to overvalue their services.

§ 52. Quasi Contracts

It will require close observation to distinguish implied contracts from *quasi* contracts. A *quasi* contract is a contract implied in law from the circumstances and without regard to the intention of the party who is bound. For example, a man staying at a hotel suddenly dies. The proprietor of the hotel calls in an undertaker who takes charge of the funeral preparations. The undertaker sends his bill to the executors of the man's estate. In this instance there was no consent on the part of the man or his representatives, yet by law it was implied that his estate should be bound for the obligation, and that there was a *quasi* contract to that effect.

The following is another case of *quasi* contract: In California a law was passed providing for a certain number of pilots to meet ships coming into the bay of San Francisco and take the ships in. Each ship was to pay its pilot a certain sum. Therefore, if a pilot took the trouble to go out to meet a ship and the officers did not wish his services, he would have to be paid a sum, if not the full and usual fee, enough to pay for his time and trouble in meeting the ship.

§ 53. Executory and Executed Contracts

An executory contract is a contract that has been made but has not as yet been carried into effect.

An executed contract is one that has been carried into effect by both parties. A contract that has been carried out by one party and not the other would be executory from one point of view and executed from the other point of view.

§ 54. Conditions Precedent and Subsequent

A condition precedent is something to be performed before the other party can be required to do his part. It is sometimes called an executory condition. In the usual contract of employment it is necessary to do the stipulated work before there is any claim for payment. The performance of the work is the condition precedent. (See also §§ 109, 110.)

A condition subsequent is a condition attached to a contract the fulfilment of which will discharge the obligation. The simplest instance of this is the purchase of goods with the privilege of returning them within a certain number of days after the goods are sold. If the goods are returned the contract of sale is annulled, and the purchaser is not liable for the price, or if he has paid he will be entitled to have the amount refunded.

A chattel mortgage is another instance of a condition subsequent. If the condition is performed and the payment secured or made, the chattel mortgage becomes void and the person who makes the payment has clear title to the goods.

§ 55. Void and Voidable Contracts

A void or unenforceable contract is one which has no legal effect and on that account cannot be enforced. It is not necessarily an illegal contract, though an illegal contract would be a void contract.

A voidable contract is not absolutely void. but it can be

avoided by one of the parties concerned. A contract with a minor can be enforced by the minor but if he does not wish to carry it out he can avoid it. (See § 38, "Minors.")

§ 56. Drafting a Contract

Where an important contract is to be drawn up, a lawyer should be employed. Where the contract involves nothing more than a simple sale, a contract of hiring or other ordinary business transaction, any intelligent man who knows how to use the English language should be able to draw up a plain, understandable statement of what the parties undertake to do. A chapter in the latter part of this book has been given to this subject. (See Chapter XCVIII, "Drafting a Contract.")

REVIEW QUESTIONS

1. Classify contracts as to grade or ease of legal proof. What is the difference between simple and formal contracts?
2. How must an oral contract be proved?
3. What data should a written contract contain?
4. What is the Statute of Frauds? What was the object of it?
By whom must the required memorandum be signed? Which are the contracts that must be in writing?
5. Where must written contracts be signed in your state?
6. In marriage, is the contract a written one?
7. When is one liable for a debt, default, or miscarriage of another?
Does a loan have to be evidenced by writing?
8. Is an oral contract to sell real estate enforceable? Give reason for answer.
9. What amount of personal property would require a written contract for its sale in your state?
10. Would a contract to write a book have to be in writing?
11. What instruments require a seal? What form of seal is required? What is a contract by specialty? What is a covenant?
12. Define contracts of record. What is a recognizance? What is the object of acknowledgment?

13. What is the difference between express and implied contracts?
14. What is a *quasi* contract?
15. What is the difference between an executory and an executed contract? May a contract be executed on one side and executory on the other?
16. What is a condition precedent? What is a condition subsequent?
17. What is the difference between a void and a voidable contract?
If you contracted to rent a house that burned before the tenant moved in, would it be illegal? Would it be a void contract?

CHAPTER VIII

EFFECT OF CONTRACTS

§ 57. **Illegal Contracts**

What constitutes an illegal contract has been explained in § 39. The point to make is that no contract which is against the law or against public policy can be enforced. If the parties come into court, both are equally chargeable with knowledge of the law and therefore with guilt in breaking it; and the court will refuse to help either or to interfere at all. If one of them has been defrauded out of his property by inability to enforce the contract, that constitutes his punishment for entering into such a contract. Such a party cannot get his property back nor can he enforce the contract.

There is a legal maxim to the effect that "ignorance of the law excuses no one." This seems harsh, but it is rigidly enforced. Therefore, if there is any doubt about the legality of a contract, the parties should assure themselves that it is in accordance with the law. Ignorance or good intentions will not excuse a man if he makes an illegal contract. (See also § 59.)

Sunday Contracts. In almost every state contracts made or to be performed on Sunday are illegal, unless they are for some purpose of charity, necessity or mercy. To be necessary, however, the thing done must be something intended to preserve life, health or property.

§ 58. **Effect of Mistakes**

There are two kinds of mistakes possible in making a contract:

1. A mistake as to whom one is dealing with, what the agreement is about, or what is to be done under the contract.
2. A mistake as to the quality or the value of the subject the contract deals with, or its legal effect.

A mistake under the first heading will mean that there is no contract. A party cannot be forced to observe a contract with someone with whom he did not intend to contract, or in regard to something he did not consider. The parties must be considering the same thing and must be agreed as to what is to be done about it, or there is no meeting of their minds and no contract.

If, however, there was no mistake as to the parties, or as to what the contract was about or what was to be done, the fact that either or both of the parties believed that the subject of the contract was more or less valuable than it actually was will not make any difference as to its binding effect. An agreement has been made and they will be held to it even if it means loss to one of them.

Neither will it make any difference if either or both of the parties did not realize that he would be bound by the contract or did not know just what he was required to do under the law to carry out his agreement. Every man is supposed to know the law, and it is his own fault if he failed to find out about it in the first place.

If a person knows that the instrument he is signing is a contract, and fails to read it, he will be bound by it even though it is a contract to do something entirely different from what he intended. No one should ever sign contracts without reading them.

In case, however, through the fault of some clerk in writing the contract an error of some sort gets into the written document so that it misrepresents the actual agreement be-

tween the parties, the court will order it rewritten to express what they really agreed upon. That is, a clerical error will be corrected.

Note:

1. The terms of a contract should be written down clearly and in simple language. Both parties should then read them over, and any questions that arise should be cleared up before signing. Much trouble and litigation would be saved if this course were followed in all cases.

§ 59. Effect of Fraud

If there is any fraud in inducing a party to enter into a contract, he may refuse to perform his share of the agreement. If the contract is already carried out, he may recover his property or its value. If he wants to annul the contract, however, he must return anything he has received under it unless it has been used up or destroyed at the time he discovers the fraud. If he prefers, he may let the contract stand and claim damages for any loss he may have suffered.

What Constitutes Fraud. If any false representation is made by a person who knows it to be false or has no positive belief or adequate knowledge in regard to the matter, intending to induce action and to create a false impression in the other party's mind, or to prevent him from investigating to find out the truth about the transaction, it amounts to a fraud. Misstatements about unimportant matters, or mere expressions of opinion in recommending an article for sale, do not affect the contract. The buyer must be on his guard against overstatements of opinion by the seller as to the virtues of the article he is selling. Overstatements are to be expected everywhere.

When a party relies on the opinion of an expert, however, or when he seeks advice from a person in whom he has a

right to repose confidence, such as a father, a guardian, or an attorney, it is a different matter. Then an expression of opinion without sound grounds would amount to fraud.

If the reading of a contract be dispensed with as the result of fraud, the injured party may refuse to live up to the terms of the contract, or he may claim damages for the injury sustained. This rule holds good also whenever the legal effect of the contract has been misrepresented or when a fraudulent value is placed on that which is being bought or sold.

The injured party must act promptly as soon as he discovers the fraud. By delay he may lose his rights, since he will be considered to be content with the terms of the contract.

Taking advantage of another person's mistake is fraud.

In *Shelton v. Ellis*, *Shelton & Co.* learned of a mistake in the rate sheet of the Western and Atlantic Railroad Company by which the fare from Atlanta, Ga., to Rogers, Ark., was quoted as \$21.25 when it should have been \$36.70. They induced Garland, a traveling salesman, to buy a large number of tickets for them before the railroad company discovered the mistake. The court held that the tickets must be returned.¹

If any part of the representations which induced the other party to enter into the contract was fraudulent and had any effect in inducing him to agree to it, the fact that most of the representations were honest will not make the contract good. But if the fraudulent representations referred to matters of no consequence and were not material to the contract they will not affect it. Also, if the other party relied on his own judgment in the matter, rather than upon what was told him, the fraudulent misrepresentations will make no difference.

What Fraud Will Nullify a Contract. Fraud in any of the negotiations leading up to a contract will nullify it. If fraud has prevented the party from making an independent investigation, or if it has led him astray in regard to the facts, it will

¹ 70 Ga. 297.

make the contract void. Fraud not connected with the immediate contract but with previous negotiations will not affect the present contract.

Specious Schemes. Ordinary people of the salaried and the professional classes lose money running up into millions of dollars by investing in all sorts of specious get-rich-quick schemes. If they would study the prospectuses of these schemers, they would see how carefully they are written so as to avoid any positive statements but to give a strong impression by a series of carefully worded opinions, estimates, etc. Such phrases as, "it is estimated," "it is expected," "there is every reason to believe," "it is the opinion of old miners," are used again and again. It is astonishing how plausible a prospectus can be made without giving any positive statement, except as to comparatively immaterial matters. The important matters in deciding upon an investment are:

1. The character and the experience of the management.
2. The amount of capital there will be available.
3. The subject matter of the business.

On these essential points there is rarely any positive information in prospectuses of this sort.

Note:

1. Consult your own lawyer or banker before investing money.

§ 60. Duress

A party must consent to a contract of his own free will. That is the essential element of an agreement. Consequently, if his will is overpowered by that of someone else, the result cannot be a contract that will hold him.

There are two ways in which a person may induce another party to make a contract against his own free will. One is by

the use of intimidation or force, the other is by taking advantage of mental weakness or of affection to influence him.

If a party signs a contract in order to escape from imprisonment or detention of some kind, he has signed under duress and not of his own free will and the contract cannot be enforced. If he signs it in fear of immediate bodily harm, which he has every reason to believe the other party is capable of inflicting, the same holds true. In a case where there is no detention but merely threats, the threats must be either of bodily harm or of imprisonment to the person himself or to some member of his family, or of an injury to his property, and must have been made under such circumstances that a man could reasonably believe that there was immediate danger of their being carried out.

As soon as a party escapes from duress or from fear of the threats that coerced him, he may rescind his contract and recover any property or other consideration, or value therefor, that was taken from him under the contract.

§ 61. Undue Influence

Undue influence is when one party takes advantage of another through near relationship, such as that of attorney and client, doctor and patient, guardian and ward, etc.; or when the second party is mentally weak and at the mercy of his more keen-witted fellow men. A deficient person can hardly be said to exercise his own free will; contracts can readily be imposed upon him by others, and when this imposition can be proved, contracts made with him have no legal standing.

When a person takes advantage of mental weakness, or of near relationship, or of confidence reposed in him to influence another person to make a contract, it is not the free action of the second party and is no contract. People who are merely friends are not considered to be in such a position that the one can exercise an undue influence over the other. Where the

consideration for a contract is plainly inadequate, it may raise a suspicion of undue influence.

If the person recovers his mental health, or is separated from the party who influenced him, he may refuse to carry out his contract and recover anything he has turned over to the other party under it.

His friends and relatives may also act for him in order to protect his property while he is still under the influence of the other party, or too incapacitated mentally to act for himself.

Note:

1. No contract is of any value unless it is made by the free and unbiased will of both parties.

§ 62. Law as to Alteration

Any alteration in a written contract by one of the parties without the consent of the other, makes the contract of no effect as against the other.

The parties to a contract may alter it if they can agree on the changes to be made. If it is a written contract, one of the parties may make the alterations in the contract itself with the consent of all the other parties, or the parties may make a new written contract. If parties attempt to modify a written contract by an oral agreement there must be a new consideration for it distinct from that of the original contract, so that in effect a new and oral contract has been made.

A New Agreement. If the same parties make a new agreement about the same subject which is entirely inconsistent with the old agreement, the old agreement will be regarded as set aside by the new. If, however, there is any part of it which is not inconsistent with the new, that part still remains enforceable. (See also § 69.)

If one of the parties to a contract makes alterations in it without the consent of the other parties to it, this amounts to fraud, and the contract becomes unenforceable by the guilty

party. If a person, not a party to the contract, and not acting for any of the parties to it, should make alterations in it, they would be treated as though they did not exist. The nature of the original contract could be proved by the testimony of the parties, and the contract would be enforced as it stood before the alterations were made.

Filling in a Contract. If the contract is not complete, however, but blank spaces have been left for any of the terms to be filled in later, any party to it to whom it is entrusted may fill out the blank spaces in any way which would be consistent with the other terms of the contract and enforce it as he has made it. If he were given instructions for filling it out, he himself could not enforce any other contract than one that was in accordance with the instructions, but he might fill it out contrary to the instructions and transfer it to another party, who, knowing nothing of the instructions, would be entitled to enforce it as he received it. This question arises more often in the case of negotiable instruments and will be spoken of under that heading. (See § 161.)

Notes:

1. The best way to change an existing contract is to make a new written agreement signed by all the parties.
2. A new contract may be made by letters if they point out clearly what the new agreement is.
3. It is not safe to leave any written instrument with unfilled blanks.

§ 63. Interpretation of Contracts

A contract should be so clear that its meaning may be easily understood. As a matter of fact, many contracts are far from clear and all sorts of disputes arise over their meaning. A contract should be interpreted so as to carry out the intention of the parties as nearly as may be. The court will

try to interpret a contract in such manner as to make it lawful and enforceable. In this matter law and common sense coincide. A contract will be interpreted according to the law of the state where it was entered into.

In getting at the intention of the parties where the contract is not clear, anything which is unessential and tends to confuse the meaning will be disregarded. If there are two statements which absolutely conflict, the court will consider that the first gives the true meaning and will disregard the latter.

The parties may bring in evidence to show the meaning of any technical terms which were used, or to prove some well-recognized custom or usage of business which will explain the meaning of certain terms, or which may be considered part of the contract.

If a contract refers to any other papers or documents, these will be read in connection with it.

Rules to Ascertain Meaning of Contracts. There are certain general rules which the court will always follow to get at the meaning of a contract. One is that in a printed form which has been filled out, if the written and the printed words are inconsistent, the court will disregard the printed words and follow the written ones. If any words or phrases are inconsistent with the rest of the contract, and a clear intention can be gathered from the rest without them, the court will treat them as surplusage.

If a general term is used, such as an agreement to do the "mason work" on a building, and it is followed by the mention of any specific kinds of mason work, such as "stone and brick work," "plastering," etc., it is a contract to do only the special kinds of mason work mentioned and not *all* the mason work on the building. In order to make a general contract for all the mason work, this intention should be clearly stated.

If any of the terms of a contract were intentionally made ambiguous by one of the parties for the purpose of taking

advantage of the other party, the court will interpret the doubtful terms in the way that will least favor the party at fault.

In trying to decide what the parties intended where the meaning is doubtful, the court will be influenced by the words and the acts of the parties at the time of making the agreement, or the manner in which they have carried it out since. Their manner of carrying out the conditions shows what they understood by the agreement.

Notes:

1. A contract should always be stated in the simplest and most intelligible language possible, and the parties should go over it carefully to make sure that all of the terms are clear.
2. If it be desired to make it with reference to some particular business custom, it would be well to mention that custom in the contract so that there can be no doubt that both of the parties understood that it was to be part of the contract.

REVIEW QUESTIONS

1. Is the rule in regard to ignorance of the law just? Why is it enforced? What is the law in your state in regard to Sunday contracts?
2. Explain the distinction between mistake of party, subject matter or obligation, and mistake of the quality, value, or legal effect.
3. What is the effect of signing a contract without reading it? If the party had dispensed with reading because of fraudulent statements of the other party, would that affect the situation? What is the effect of a clerical error?
4. Broadly, what is the effect of fraud on a contract? What is fraud?
5. Distinguish between misrepresentation and expression of opinion. When is the expression of opinion liable to be fraudulent?

6. Can a person take advantage of another person's mistake?
7. Do fraudulent representations always make a contract void?
What are the exceptions?
8. How are prospectuses worded to avoid open fraud? What are the three vital points in any proposed investment?
9. What does "duress" mean? What is its effect on a contract?
10. What is meant by "undue influence"? What is its legal effect on a contract?
11. What is the law as to altering a contract? What is the best way to alter a contract? Why?
12. Disputes often arise over the interpretation of contracts. Why?
13. What is the object of the rules for interpreting contracts?
14. A bought a cash register on the statement that it would save the expense of a bookkeeper and one-half of the clerks' time. After a short time he alleges that the statement was false and seeks to rescind the sale on the ground of fraud. Was this fraud, or statement of opinion, and what is the result?

CHAPTER IX

ASSIGNMENT AND NOVATION

§ 64. Assignment of Contracts

A contract which calls for personal services cannot be assigned by either of the parties to it. No one can be compelled to work for a person unless he agrees to it; and no one can be compelled to have another working for him whom he did not choose, and these conditions would result if such contracts could be assigned.

A contract which depends on the skill, ability, or trustworthiness of one of the parties to it cannot be assigned by that party, but may be assigned by the other party. For example, a contract to write a poem cannot be assigned by the poet, but may be assigned by the publisher.

The rights in any other contract may be assigned by either of the parties to it unless there is something said in the contract to forbid it. A party may assign a contract by simply handing the written contract over to the party to whom he assigns it, or by informing the other party to the contract by word of mouth that he has given up all his rights under it to the person to whom he wishes to assign it.

Where the party desiring to assign a contract is under obligations under the contract, he cannot assign these without the assent of the other party to the contract (see § 65, "Novation"); otherwise he would still remain liable for whatever he had bound himself to do or to pay in the contract.

Form of Assignment. The proper way to assign a contract is in writing, usually on the back of the contract, if it is in writing, or if it is an oral contract, by a written assignment.

In the case of contracts under the Statute of Frauds, the law requires the assignment to be in writing. No particular form of words is necessary if the intention to transfer all the rights in the contract is plain. (See Chapter C, Forms 18 and 19.)

Liabilities of the Assignee. A person to whom a contract is assigned by one of the parties becomes liable to perform all the duties of the party who assigns the contract. He receives only such rights as the original party enjoyed under the contract. If the contract was obtained by fraud, duress, or undue influence, or the other party to it was not competent to make a contract, such other party may refuse to perform it just as much as though the assignee were one of the original parties.

If the party who assigned the contract owed the other party anything which could have been offset against the contract, the other party may offset that amount against the person to whom the contract has been assigned.

Rights of Assignee. If a party should assign all his rights under a contract to one person and afterwards assign them to another, the second person would get no rights under the contract. If the party assigned only part of his rights to the first person, the second person might enforce such rights as remained. The second person would be entitled to sue for damages the party who claimed to assign the contract to him.

Subject to the rights of the other party, the person to whom a contract has been assigned may bring a suit to enforce it in all cases where the party who assigned it to him would be entitled to do so. In some states, if he sues in a court of law, he must bring his suit in the name of the person who assigned the contract to him. He may sue in a court of equity in his own name. In a case where there have been several assignments, the suit must be brought in the name of the party who gave the first assignment.

A person to whom a contract has been assigned should notify the other party to the contract at once that the rights under the contract have been assigned to him. If there has been an assignment to any other parties, the one who is the first to give this notice will be entitled to have his rights enforced first. Then, too, it prevents the other party from paying out anything to the person who has assigned the contract. If such payment has been made in ignorance of assignment, the party to whom the contract has been assigned could not compel payment again to himself.

Notes:

1. All contracts which do not involve the personal element may be assigned unless prohibited by the law or by public policy.
2. Any form of assignment which cuts off all control of the assignor over the contract will be sufficient.
3. The assignee takes all the rights which the original party had in the contract, and the contract is subject to all the defenses which have arisen prior to its assignment.
4. The assignee should always give the other party prompt notice that the contract has been assigned to him.

§ 65. Novation

Novation is the substitution of other parties, or another party, for one of the original parties to the contract.

Where John Smith has an agreement with Henry Jones to buy a horse for a certain sum, and instead of doing so he assigns the contract to Samuel Brown, and Henry Jones agrees to take Samuel Brown as party to the agreement, this is a novation. Samuel Brown has been substituted for John Smith in the contract, which can now be enforced against him, Samuel Brown.

Agreement of Parties. In order to constitute a good novation, all the parties must agree to the arrangement. Henry Jones must discharge John Smith from his agreement to pay for the horse, and take Samuel Brown's agreement in place of it; John Smith must have assigned all his interest in the contract to Samuel Brown, whose agreement to pay for the horse is the consideration for Henry Jones's acceptance of him as a substitute for John Smith. If any of these considerations are lacking, the novation will not be enforceable.

In *Ford v. Adams*,¹ Jacob Schyer owed Ford some money. He gave a written order to Adams, who owed him, Schyer, to deliver 40 cords of wood to Ford. Ford accepted the substitution. Adams did not deliver the wood, and Ford sued him for it. The court said that there was not a good novation, because it was not shown that Schyer had released Adams's debt to him, and without that there would be no consideration to Adams for his promise.

Notes:

1. To constitute a good novation, the other party to the contract must accept the substitution and must release the party making it from his obligation to him.
2. The party making the novation must assign to the new party all his interest in the contract.
3. All of the parties must accept the new arrangement.

REVIEW QUESTIONS

1. Why cannot a contract for personal services be assigned?
2. Can a written contract be assigned orally?
3. Write an assignment of a written contract.
4. What does the assignee of a contract have to do?

¹ 2 Barb. (N. Y.) 349.

5. What rights would an assignee have? Can an assignor relieve himself of his liability under a contract by making an assignment?
6. Why should an assignee notify the other party to the contract promptly?
7. What is novation? How many parties to a novation?
8. Distinguish a novation from an assignment.
9. Write an assignment of an account.

CHAPTER X

DISCHARGE OF CONTRACTS

§ 66. Discharge by Performance

The usual way to discharge a contract is by performance or fulfilment. This means performance by both of the parties. Performance by only one of the parties releases that party from liability on the contract, but does not discharge the contract or release the other party from his obligation.

Under the old common law rule, the performance must be strictly in accordance with the provisions of the contract. This has worked so much hardship and real injustice that equity has modified the doctrine, and allows a substantial performance with damages to compensate the other party for any loss he has sustained.

Substantial Performance in Construction Contracts. If the variations in performance of an agreement were intentional, they would amount to breach of the contract. Where they were not intentional, the other party is entitled to deduct from the price the value of any such omissions as there may have been, and to have them repaired himself if he desires. This rule applies especially to construction contracts, and even in an action at law substantial performance will be sufficient.

In *Heckman v. Pinkney*, Heckman had a contract to do the carpentry work on a house that was being built for Pinkney. He failed to make cornices and to put centerpieces in some of the rooms according to the agreement; and the material for deadening the floors did not have hair in it, as had been stipulated. The court said that the variations were

not intentional or material, and that the contract had been substantially performed.¹

At law, time is of the essence of a contract; that is, performance must be within the time specified, or the party guilty of delay will be liable for damages for non-performance. If, however, the injured party accepts performance after it is due, he must pay the fair value of what is done, though he is allowed to deduct damages for the delay.

In equity, time is not of the essence of the contract unless it has been expressly agreed that it shall be. That is, a court of equity will often enforce the contract in favor of the party who has delayed, unless in fact or by express agreement failure to perform on time amounts to failure to perform at all.

Where the parties agree that the contract must be performed to the satisfaction of one of them, nothing which does not satisfy him will be performance. At the same time, he must be honest about his dissatisfaction and not pretend to be dissatisfied when he is not really so. Sometimes there is an agreement that the judgment of a third person shall be the test as to whether the contract is performed or not. In such case, the contracting parties must abide by his judgment, unless he is mistaken or fraud is shown.

Notes:

1. Performance must be substantially in accordance with the terms of the contract.
2. Where time is material to the contract, the performance must be within the time set.
3. Where the parties agree that the performance must be to the satisfaction of one of them, or to the satisfaction of a third party, the honest judgment of that party is the test of whether or not the contract has been performed.

¹ 81 N. Y. 211.

§ 67. Discharge by Agreement

An agreement between the parties to rescind a contract, or a later agreement between the same parties with regard to the same subject matter, the provisions of which later agreement are inconsistent with the contract, will discharge the original contract.

The agreement to rescind the contract must, like all other agreements, conform to all the rules governing contracts. The release of one party from his obligations is the consideration for the release of the other from his. But, where one party has performed his part of the contract, there must be some new consideration to him for releasing the other, or the agreement to rescind will not be enforceable.

There is only one case in which the parties may not agree to cancel a contract, and that is when it was made for the benefit of a third person and the third person has notified them that he accepts it. At any time before he accepts they may declare the contract void. For instance, a farmer might come into town and tell a storekeeper to send away and get a suit of overalls for his hired man and he would pay for them. He informs the hired man of what he has done and the hired man tells the storekeeper that he will call for the overalls when they are expected. At any time before the hired man told either the farmer or the storekeeper that he would take the overalls, they might have cancelled the contract, but not afterwards. In all the states, with the exception of Massachusetts, Michigan, New Hampshire and Vermont, a third person may maintain an action for the breach of a contract for his benefit.

If two parties to an agreement make a new agreement about the same subject matter which is inconsistent with the old agreement in any way, the old agreement will be discharged to that extent. For instance, in an agreement of novation (see § 65), by accepting the substituted party, the

other party discharges the party making the novation from his obligations under the contract.

If the parties put an oral agreement into writing or instead of a written agreement make a new contract under seal, the old contract is discharged and they are bound only by the new agreement.

Notes:

1. The parties may agree together to rescind a contract, except that where it was made for the benefit of a third party, they may not rescind it after he has given notice of acceptance.
2. A later agreement, between the same parties and with regard to the same subject matter, the terms of which are wholly or partly inconsistent with a prior agreement, revokes that agreement so far as it is inconsistent with it.
3. An oral agreement is superseded and discharged by a later written agreement, and a contract in writing but not sealed is superseded by a sealed instrument.

§ 68. Discharge by Various Other Causes

Operation of Law. A contract may be discharged by the operation of law. When a contract is discharged by the making of a new written or sealed contract, as has already been explained (§ 67), it is discharged by the operation of the law which declares that a written instrument is of greater value than an oral agreement, a sealed instrument than a written contract. When a person goes into bankruptcy, the law discharges all of his contracts with a few exceptions.

Impossibility of Performance. There are some cases in which impossibility of performance discharges a contract. If it were for some particular article which could not be replaced and the article were destroyed, or if it were a contract for

personal services and the person to render the services became ill or died, the contract would be considered discharged, and there would be no liability for damages. The parties are considered to have realized that if such a thing were to happen the contract could not be performed, and to have made the contract on the understanding that it would be carried out only in case the article were in existence or the person were able to perform at the time. If the one party to a contract by his acts made performance impossible, it would discharge the other party from all obligation. Contracts for the payment of money are not discharged by the death of either party, but contracts involving personal skill, trust or confidence between the parties are discharged by the death of one of the parties. This does not, however, apply to contracts which can be carried out by the executors of the deceased, such as to have a house built or painted.

Act of God. Where the performance becomes impossible by what is known as an "act of God," that is, a tornado, a hurricane, a flood, a conflagration, or some other accident or disaster amounting to a public calamity, the contract is discharged. Ordinarily a person takes the risk of the contract being impossible to perform if he does not make some provision for it in the agreement, and impossibility of performance is no excuse.

In the case mentioned in § 41, where the subject matter was destroyed at the time the contract was made, if one of the parties knew of it, he will be held liable for a breach of the contract, notwithstanding that it is impossible for him to perform it. In the case of a contract where one of the parties promises to do one of two things, if one of those things was impossible at the time the contract was made, he must perform the other.

In Case of War. When two countries go to war, all possibility of friendly relationship between them ceases. All

contracts between their citizens on which nothing has yet been done are discharged. If anything has been done by either party under a contract, and it is possible to do so without injustice to either party, the contract will merely be suspended until the war is over, when it must be carried out fully in accordance with its terms.

Effect of Strikes. A contract may provide in itself that it is to be discharged on the happening of certain conditions. It is very common to provide against strikes, etc., in this way. The provision, however, must be in the body of the contract to be good. A notice at the top of the firm letterhead that all sales were to be subject to strikes or accidents would not form part of a contract written under such letterhead.

As a general rule, printed conditions on a letterhead are not binding on the party receiving the letter. If any matter is important it should be written in the body of the letter.

Lapse of Time. Any contract is supposed to be performed within a reasonable time. Even if no time for performance be given in the contract, it will nevertheless be discharged if a long period of time goes by without anything being done on it by either party.

Offer to Perform. If due performance is offered by one party and is not accepted by the other, the first party is discharged.

Notes:

Contracts may be discharged:

1. By the operation of conditions agreed to by the parties.
2. By merger or alteration of a written instrument, or by the discharge of the party in bankruptcy.
3. By lapse of time if delay is unreasonable.
4. By an offer to perform, if it was refused by the other party.

5. By impossibility of performance, where the impossibility is caused by the act of the other party; by the operation of law; by a declaration of war; or by the destruction of the subject matter where the contract concerned a particular article or was for personal services; but not otherwise.
 6. In making contracts to handle orders, to carry on construction work, etc., involving large amounts, where there is a possibility of strikes and various labor disputes preventing the finishing of the work at all, or at least within the time limited by the contract, parties should always provide against such delays. It is usually safe to have a fire clause, and to provide against destruction by floods, tornadoes, etc.
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REVIEW QUESTIONS

1. What is meant by the discharge of a contract?
2. What is meant by substantial performance?
3. What is the rule as to time of performance, at law? In equity?
4. Is it safe to agree to make performance to the satisfaction of an interested party?
5. What is meant by "discharge by agreement"?
6. If one party had performed his part of the contract, could the parties agree to rescind? What element would be needed legally to rescind a contract?
7. What effect does the interest of a third party have?
8. What is the effect of making a new contract of greater dignity than the old contract?
9. What is the effect of bankruptcy on pending contracts?
10. What is the effect of impossibility on a contract? What is the situation when a contract becomes impossible but the contract is not discharged?

11. In what cases does impossibility discharge the contracts? What kinds of contracts are discharged by the death of the party to perform?
12. What is the effect of specifying certain causes as operating to discharge the contract?
13. A father conveyed land to his son on his son's covenanting to pay an annuity to his mother on her widowhood. May the mother maintain an action, not being a party to the covenant?
14. B orally requested A to do certain carpentry work around his house in the nature of repairs. B died. A subsequently performed the work and brought suit against the administrators for the price. Can he recover? If so, why so; if not, why not?
15. Does outbreak of war nullify contracts if it simply changes prices?
16. What is the effect of lapse of time and non-performance?
17. If one party offers to perform and the other party does not accept, what is the effect as to each party?

CHAPTER XI

ENFORCEMENT OF CONTRACTS

§ 69. Breach of Contract

The obligation of a contract is an obligation created and determined by the will of the parties. Herein is the characteristic difference of contract from all other branches of law. The business of the law, therefore, is to give effect so far as possible to the intention of the parties, and all the rules of interpreting contracts go back to this fundamental principle and are controlled by it.¹

A contract may be broken by either party in one of several ways, such as:

1. Failing to perform the contract.
2. Refusing to perform the contract.
3. Making it impossible for himself to perform the contract, or denying that there is such a contract.

Failure to Perform. If a party breaks a contract by failing to perform it, the other party must have done all that can be required from him under the contract before he is entitled to bring suit. If his part of the contract was to pay *after* the other party had performed it, he need not pay until such performance.

If a party was to perform work or to deliver goods for which the other party was to pay, he must be able to show that he has either performed or offered to perform the work, or that he has delivered or offered to deliver the goods, before he has any right to claim damages. A party must remain

¹ Encyc. Brit., 11th Ed., Vol. VII, page 38.

ready and willing and in a position to perform what he agreed during the entire time of the contract; it is not enough once to have made the offer.

It is often hard to determine just when a contract has been broken by failure to perform. Unless the time within which it was to be performed was an important part of the value of the contract, the courts usually give parties what they consider a reasonable time in which to complete it, whether the contract sets a definite time for its completion or not.

A Reasonable Time. The difficulty is to know what the court will consider a reasonable time. The parties may, however, have this determined beforehand by stating in the contract that "time is of the essence (that is, an essential part) of this contract," in which case the court will enforce it within the time specified. Or, if this has not been done, the party for whom the services were to be performed or to whom the goods were to be delivered, etc., may demand that the other party fulfil his part of the contract within a certain time or he will consider it broken. If he has really given the other party a reasonable time, he will have a right to bring action if the services agreed upon have not been performed within that time.

A party is always allowed until the last minute of the time set to perform, and the day on which the contract was dated or the demand made will not be counted as a part of that time; for instance, if the contract was dated or the demand made on July 1, giving him 30 days in which to perform the contract, the time will not be considered to have expired until midnight of July 31.

Refusal to Perform. If a party refuses to perform the conditions of the contract when the time comes for performance, he also relieves the other party from further obligation and gives him an immediate right to sue for damages.

If a party refuses to carry out a contract before the time for its performance has arrived, in some states the other party has a right to regard this as final, but in the other states he must wait until the time for performance has passed before he is entitled to bring suit.

When a party notifies the other party that he does not intend to perform his part of the agreement and tells him to stop work on it, the latter, if he accepts the notice, should stop work immediately. He may, if he prefers, however, ignore the notice and treat the contract as still existing by continuing to perform his part, though he may not collect for work performed after notice.

Denial of Contract. If a party denies that there is a contract, or makes it impossible for himself to perform it by disposing of its subject matter in some way, the other party is immediately relieved from all obligations and has the right to sue at once for the damages he has sustained.

Notes:

1. Refusal to perform a contract is a breach of the contract.
2. Making it impossible for one's self to perform a contract is a breach of the contract.
3. In either of the cases cited above, the other party may abandon the contract and sue at once for damages.
4. Failure to perform one part of a divisible contract is not a breach of the entire contract, and does not excuse the other party from performance of the rest.
5. In case of a breach by failure to perform, the other party must show that he has performed his part, or was ready and willing to do so, before he can claim damages.

6. Where a contract has been partly performed by one party, the other party must carry out his part of it, unless the first party has refused to perform further, or the circumstances are such that he would not be able to perform the rest of it.
7. The party who broke the contract must be paid the reasonable worth of what he has done on it, unless his breach of it was wilful or the contract provided that he should have nothing unless he performed the whole.

§ 70. Remedies for Breach of Contract

The party who is injured by a broken contract may either (1) sue for damages, or (2) he may abandon the contract and sue for the value of his services or of the goods furnished.

The moment a contract is actually broken the other party has a right of action for damages, but there must be an actual breach. People are inclined to rush into court when they think that their contract rights are disregarded, without stopping to make sure that there has actually been a breach.

When parties to a contract agree on the amount that shall be paid in case of breach or default, such amount is called *liquidated damages*. The plaintiff in an action for breach of contract can sue only for profits proved to have been lost, and not for estimated profits lost. The jury would judge the amount of his actual loss from the evidence submitted.

Action for Breach of Contract. If an action for breach of contract is to be brought at all, it is best to do it as soon as possible after the contract has been broken, as the court may consider that a person has voluntarily surrendered his right if he waits too long, or possibly something may happen that will excuse the other party from performance. But there is one class of contracts in regard to which a great deal of care must be taken when bringing suit; these are contracts

where there are several parts entirely separate from and having no connection with each other. If it is perfectly clear that they are separate, a party would have a right to sue for a breach of one of the parts at once without affecting his rights under the rest of the contract. For instance, a breach of warranty in a contract would give a right to damages for that warranty without in any way affecting the rest of the contract.

Where one of the parties is prevented from performing a contract for personal services by sickness or death, he or his estate may recover the value of what he has already done; and where a contract has been partly performed by one of the parties and the other party has received any benefit from what has been done, he must pay for it unless the breach was wilful and intentional.

When Specific Performance Can Be Had. There are some exceptional cases in which an action for damages would not be an adequate remedy for the injured party, and in such a case a court of equity will compel the first party to perform the contract.

In *Marsh v. Blackman*, Mrs. Marsh agreed with the two sons of Judge Blackman to take care of their father until his death for \$2 a week. They later notified her that they refused to perform the contract. The court said that it would be impossible to compute the damages with any certainty as their amount would depend on the length of Judge Blackman's life, and that it would therefore compel the two sons to carry out their agreement.² (See § 74, "Specific Performance.")

Instalment Contracts. But in contracts, for instance, which are to be performed by instalments, such as a contract to deliver 1,000 barrels of oil at the rate of 100 barrels a

² 50 Barb. (N. Y.) 329. (This is an old case, before the high cost of living became noticeable.)

month until the contract is completed, it is not perfectly clear whether a failure to deliver one lot of 100 barrels would be a breach of the whole contract or not. The courts in the various states hold different views on this question. If a party brought an action for damages at once, he might find himself cut off from any further damages in case of the other party's failing to deliver the rest of the oil; or if he treated the contract as broken he might find himself the one guilty of breaking it. The only safe thing to do in these cases is to consult a local lawyer.

When a contract is to be performed to the satisfaction of a party thereto or of a third person, such as an architect or an engineer, the work must satisfy the person designated, but, as a general rule, the court will hold him to what it considers reasonable.

Breach by Failure to Perform. A breach by failure to perform does not usually take place until the time for performance has passed. However, in contracts where goods are to be paid for in instalments, or rent is to be paid by the month, if the contract is an entire and not a divisible contract, failure to deliver one instalment or to pay one month's rent will be a breach of the entire contract. Where the contract is a divisible one, failure as to a separable portion is a breach of that part of the contract, and the party may sue on that while the rest of the contract is being performed.

It must be borne in mind that if the breach was of one provision of a divisible contract, the party suing must show that he performed whatever was due from him under that provision before he can claim damages for its violation.

A divisible contract is one in which the obligation consists of independent parts, not necessarily united, as, if one agreed to deliver 100 bushels of corn in March and 100 in April, or to deliver at the same time 50 bushels of onions and 25 bushels of potatoes. An agreement to do several things at

several times is divisible, unless the consideration to be paid is entire.

Breach by Refusal or Denial. Where the party positively refuses to perform, or denies the existence of the contract, an action may be brought at once for a breach of the contract. The other party does not need to do anything further on the contract himself, and, if he does do anything further, cannot recover anything for the extra work, for the plaintiff has no right to aggravate the damages. There must be, however, a positive refusal to perform under any conditions.

Time to Bring Suit. The party has always a right to ignore an intermediate breach and to wait until the time for final performance arrives before bringing suit; but if he does this he takes the risk that some other happening may discharge the contract before that time. If, on the other hand, he waits until the time for performance, he is entitled to all the damages which he has sustained up to that time. In any case professional advice should be secured and followed.

Notes:

1. Where there is a contract for the delivery of goods or the performance of work by instalments, and there is a failure to perform one of the parts of the contract as agreed upon, a party ought to consult a lawyer as to his rights before making any statements to the other party about it.
2. It is always a matter for serious consideration whether a breach of contract justifies a remedy so costly and uncertain as a suit at law. (See Chapter IV, "Law and Equity.")

§ 71. Law Governing Remedy

It has already been explained (§ 40) that a contract is interpreted in reference to the law of the place where it was made, unless the parties state that they intend it to be governed

by some other law ; but if they specify some other law merely to evade the law of the place where the contract was made, the local law will govern despite their provision.

In bringing an action on a contract, the method of bringing it, the right to bring it, and the defenses that may be made to it, are all governed by the law of the place where it is brought, and defenses which may be made in some states cannot be used in others. The Statute of Limitations (§ 72) differs in the different states, so that a contract on which an action may not be brought in one state may be sued on in another if the party to be sued is subject to its jurisdiction.

Note:

1. The place to bring suit is a matter regarding which it is necessary to seek legal advice.

§ 72. Statute of Limitations

The Statute of Limitations is the law that specifies the time limit within which an action may be brought. For the sake of peace and in order to put some limit to the time in which rights of property, etc., can be upset by lawsuits, laws have been enacted in every state providing that after a certain length of time specified in the law actions may not be brought in the courts. These laws apply to all the various forms of actions, including those on contracts. If the contract is under seal, the law usually gives a longer time in which to bring action on it.

The Statute of Limitations begins to run, not from the date when the obligation was made, but from the date when payment is due. In cases in which demand is necessary before a party is liable, the statute begins to run from the time the demand was actually made. In the case of a checking account in a bank, the time on each check does not begin until demand is actually made or some act of the banker has dispensed with

it. If each of the parties has an account with the other, and if they clearly intended to balance these accounts against each other, the statute begins to run against the balance at the date of the last entry.

A written promise to pay the debt is sufficient to renew the contract and to furnish a new date from which the statute runs. A part payment of principal or interest of the sum due will likewise renew the contract.

Sometimes the Statute of Limitations provides that, after the time specified, the party shall have no further right of action. This means that the cause of action is dead altogether, and thus cannot be enforced anywhere. If the law of the state where the contract was made has such a statute, the contract cannot be sued on anywhere after that time has passed, because the statute is said to "go to the right of suit"; that is, it ceases to exist.

Usually, however, the Statute of Limitations merely "goes to the remedy"; that is, the cause of action remains, but the law does not allow the courts to enforce it after a certain time, and, if suit is brought after that time, the other party may plead that the law has barred the right of remedy. If, however, the other party does not plead the Statute of Limitations in such a case, the action may be brought, because it was passed only to protect him from the bringing of a suit at a time when he might not be able to get the evidence for his side, and if he is willing to fight the case on its merits he can do so.

Where the Statute of Limitations in the state where the contract was made affects only the remedy, it does not affect the contract; and the question as to whether the action may or may not be brought depends on the law of the state in which it is desired to sue. Therefore, a contract on which an action could not be brought in the state where it was made might be sued on and enforced in some other state where

a longer time is allowed by the Statute of Limitations for the bringing of the action, provided the other party lives there.

Note:

1. It is right and just that if a party sleeps on his rights he should lose his cause of action, and that men should not have to fight stale claims.

REVIEW QUESTIONS

1. To take legal action against a person who has failed to perform his part of a contract, what must the other party show?
2. What is the rule as to time? What is "reasonable time"?
3. If a tailor was to have a suit finished on the 20th of the month and it was not ready till the 25th, could he hold his customer? How would it be if the customer had told him that he was to sail for Europe on the 21st?
4. If a person had agreed to sell 60 barrels of flour and 10 barrels of apples and only delivered the apples, could he collect the agreed price for the apples? Why? Suppose that the price of flour and apples had advanced at the time of delivery, how would that affect the situation?
5. If a person is working by the month and leaves ten days before the end of his period because he can get a better job, can he collect for the time he worked?
6. How soon is it best to bring suit for a breach of contract? What is to be considered before bringing suit?
7. What law governs the interpretation of a contract? Where may suit be brought? Why?
8. What is the Statute of Limitations and on what policy is it founded? Explain fully.
9. In the state in which you live: ^a
How soon must a crime be prosecuted?
How soon must action be brought for a personal injury?
How soon must action be brought on an oral contract?
How soon must action be brought on an open account?
How soon must action be brought on a written contract?

^a The data required will be found in the Revised Statutes of the State.

How soon must action be brought to recover land?

How soon must action be brought on a sealed contract?

10. State two ways of renewing a debt so that the Statute of Limitations will recommence to run.
11. Give three ways that will prevent the statute from running against an ordinary debt.
12. Define liquidated damages in relation to a building contract.
13. If, by admitted breach of contract of A, B's business is stopped for a period, can B recover damages for profits estimated or only for profits proved to have been lost?

CHAPTER XII

ACTIONS ON CONTRACTS—GENERAL RULES

§ 73. Introductory

Besides the particular provisions of the law of the state where the action is brought, there are certain general rules which apply to actions anywhere.

Assigned Contracts. Where a contract, or a cause of action arising out of a contract, has been assigned, the party to whom it has been assigned must bring the action in the name of the party to the contract from whom he received it, unless there is a law allowing him to sue in his own name. This is the rule of the common law, but now in most states the party who has the actual interest in the contract is allowed to sue in his own name.

Joint Contracts. Where there is a joint contract, all the parties to it must be brought into the action; that is, if other parties are jointly interested with the party suing, he must join them with himself as plaintiffs. If, however, they refuse to join as plaintiffs, the law in many cases provides that they may be joined as defendants, in which case the party so joining them must explain that they refused to be joined as plaintiffs and mention the statute by which he is allowed to join them as defendants.

If several parties are jointly obligated to the plaintiff by the same contract, when he sues he must include them all as defendants. If any of the parties to the contract are left out of the suit, they are released from all obligations under it, unless they agreed in the contract to be liable individually for the whole contract apart from all the others.

Assumption of Legality. The law always assumes that a contract is legal and proper; therefore the person who asserts that it was illegal, or the result of fraud, undue influence, duress, etc., must prove the fraud or other allegation.

Notes:

1. The law of the place where the contract is made governs its interpretation unless the contract explicitly specifies otherwise.
2. The law of the place where suit is brought governs the right to bring action on it, and the defenses which may be made.
3. Where the Statute of Limitations of the place where the contract was made takes away the right of action, no action may afterwards be brought on the contract in any state.
4. In suing on a joint contract, all the parties must be joined, either as plaintiffs or as defendants.

§ 74. Specific Performance

There are some cases where damages do not repay the party for what he lost on the contract, as, for instance, if the contract was to buy some valuable work of art which he could not duplicate elsewhere. In contracts for the delivery of goods, where it is possible for the party to go out and purchase other goods of the same nature, his loss can easily be computed and covered by damages; but where it is impossible to compute the damages, or where the property purchased is a work of art, an heirloom, or something else which cannot be duplicated or easily purchased elsewhere, so that damages do not compensate him for his loss, the court will compel the other party to perform the contract. This is known as "specific performance," and is granted by what is termed a court of equity.

Land, with everything relating to it, is always regarded as having a peculiar value; so that a contract for the sale of land may always be specifically enforced.

In cases where the contract is for personal services, or cannot be carried out because the other party has disposed of the property involved, or for any other cause, the court will refuse to make a useless decree. In the case of personal services, it is not considered that any services which the other party might perform in order to escape imprisonment would be worth much. If, however, the other party has disposed of the property or otherwise put it out of his power to perform the contract *after* the suit in equity has been begun, the court of equity, contrary to its usual custom, will award damages.

Requirements of Courts of Equity. The party who brings a suit in equity must show that he has not been careless or negligent regarding his rights, but has insisted on them and promptly taken action to protect them. This carelessness and negligence are known in legal parlance as “laches,” and, unless there is some excuse for them, will prevent the delinquent party from recovering in a suit.

The party who brings such a suit must also be able to show that he has been in all respects just and fair himself, and he cannot ask the court to enforce any contract which is in the slightest degree unfair to the other party. He must show, too, that he has done everything in his power to fulfil the contract on his own part, and, if the other party has prevented him from performing it, he must show the court that he was and is able and willing to do all that was required on his part.

A court of equity will not enforce an illegal contract, or one that has been obtained by duress, fraud, or undue influence. Nor will it enforce a contract that is unconscionable, or where an unfair advantage has been taken of another

party's ignorance or inexperience. (See Chapter IV, "Law and Equity.")

Notes:

1. No court will enforce a contract which is illegal or improper.
2. Specific performance is granted only where damages would not compensate the party for his loss.
3. Courts of equity will see justice done as nearly as possible, and therefore, the party who seeks their aid must be prepared to do justice himself.

§ 75. Rules of Evidence

Certain rules have grown up with regard to the admission of evidence before a court. Some of these rules have been dictated by convenience, in order not to take up the time of the court unnecessarily; others for the sake of being fair to both parties. Some of the rules of evidence particularly concern contracts.

An oral contract must be shown by testimony. The testimony of the parties themselves, and of any witnesses who were present and heard the transaction, is competent; but anything in their conversation or relations which has no bearing on the contract will be excluded. It often happens that contracts are agreed upon between the two parties, and each remembers only the part that favors himself, and in such a case a court cannot give any relief, because the evidence balances. Where it is not possible to prove the making of the contract itself satisfactorily, evidence that the party in some way acknowledged or ratified it, or that he has partly performed it, may be introduced to show that there was such a contract.

Competent evidence is that which is admissible.

Material evidence is that evidence which applies directly to the point at issue.

Relevant evidence is evidence relating to the matter in dispute. "Whatever naturally and logically tends to establish a fact in issue is relevant and that which does not answer requirements is not."¹ Irrelevant evidence lacks close connection with the fact to be proved: is collateral to the issue.

The general rule that hearsay evidence is excluded, is based on the principle that a witness may testify under oath as to what he himself has seen or heard, but that there is no value in a man's taking oath as to what another, not under oath, has told him.

The Burden of Proof. The burden of proof is always on the party who makes an assertion; thus many cases fail, not because the party is in the wrong, but because he cannot prove his case. Judges and juries can act only on evidence brought before them, and if a case is good but there is no evidence to prove it, a court cannot give relief, and the law should not be blamed for it. This is why written contracts are so important. (See §§ 42, 43.)

The Parol Evidence Rule. The meaning of this rule is that other evidence will not be admitted to vary the terms of a written contract, because the contract itself is the best evidence of what its terms are. Oral evidence may always be introduced to support the contract. Necessarily, the performance of the contract, or a breach of it, will have to be shown by oral testimony. The same is true of abandonment of the contract; and anything which would show adequate motive may be introduced as tending to support the proof of the abandonment.

There are exceptions to the parol evidence rule. Where the contract is not clear in itself, it becomes necessary to resort to parol evidence to explain it. Any other paper or matter to which the contract refers may be proved in connection with it, and, if such paper shows on its face that the

¹ Jones on Evidence, Vol. I, Sec. 135.

transaction outlined was not complete, the whole transaction may be proved. Oral evidence may always be introduced to show fraud, duress, undue influence, or illegality in the contract. The rules of evidence may even be stretched in such a case to allow the proof of other transactions not directly connected with the contract under consideration, tending to prove a fraudulent contract.

Admissions. A party will never be allowed to use his own statements and acts unconnected with the actual contract or the transactions leading up to it, to prove that there was a contract, or that what he claims as to its terms is true, but he, however, may prove anything which the other party said against his own interest, and must also show any other statements made in connection with the admission which might have limited its effect.

Where a party employs an agent to deal for him, any admission against the employer's interest which the agent made at the time of, or during the transactions leading up to, the contract, may be used against the employer; but not admissions which the agent made *after* the execution of the contract.

Books of Account. Books of account regularly and fairly kept as books of original entry supported by oath are admitted as prima facie evidence of the entries therein contained.²

If the clerk who made the entries is dead his handwriting may be proved.

The rules in regard to admitting books of account as evidence are as follows:

1. They must be regularly kept in due course of business.
2. The entries must be made by the party or an authorized clerk at or about the time of the transactions.

² Jones on Evidence, Vol. III, § 567.

3. The books must be identified by oath.
4. The entries must be pertinent to the issue.
5. The books must come from proper custody.

These rules apply only to books of original entry, not to ledgers and other books footed from original entries.

The books of a deceased person may be used as evidence both for and against him. The books, however, must first be properly proved by the clerk who made the entries or by someone who can testify as to the handwriting of the deceased.

Transactions with a Party Later Deceased. In order to protect estates against fraud, where a person is suing to enforce a contract against the executor or the administrator of a person who is dead, he will not be allowed to testify to any transactions with the deceased person, where there were no other witnesses present to testify as to what the deceased person said or did. This is very important to remember, because, in the case of an oral contract where no witnesses were present, the party who is still living might not be able to prove the contract at all; and this is another reason why all contracts should be reduced to writing.

Notes:

1. The burden of proof is on the party who makes an assertion.
2. Any evidence, in order to be introduced, must have some direct bearing on the contract itself, or on the transactions connected with its making and discharge.
3. Parol evidence cannot be introduced to vary the terms of a written contract except in case of fraud, duress, undue influence, or illegality; or where the contract is not complete in itself or its terms cannot be understood without reference to outside circumstances.

4. A party cannot use his own words and acts as evidence in his favor; but his admissions against his own interest may be used against him.
 5. A party may not testify to his transactions with a deceased person where no other witnesses were present.
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REVIEW QUESTIONS

1. What is the rule as to actions where there are joint parties to a contract?
2. Does a person bringing suit have to prove that the agreement was fair and that the defendant went into it voluntarily? Why not?
3. When can a person be compelled to carry out a contract? In what court would such a suit be brought?
4. Can you give three "rules of equity"?
5. What is the difficulty in proving oral contracts?
6. In a suit who has the "burden of proof"?
7. What is the rule as to parol evidence? What exceptions to this rule?
8. What is the rule as to transactions with a man who has since died?
9. What is an admission?
10. What is meant by the rule, "Hearsay evidence is excluded"? Illustrate.
11. What is relevant evidence?
12. What is competent evidence?
13. State the rules as to admission of books of account as evidence in court.
14. When are books of account of a deceased person admissible evidence?

CHAPTER XIII

TENDER OF PAYMENT OR PERFORMANCE

§ 76. Definition

When a person is prevented by the other party to the contract from carrying out his part of it, he may make sure of his own rights under it by *tendering* (that is, *offering*) to pay or to perform. The offer must be made by the party himself, or by someone he has authorized, at the time the contract was due to be performed, and either at the place specified in the contract for goods, etc., to be delivered, or directly to the other party or any agent he has appointed to receive them. For instance, if the other party had ordered goods to be delivered to a railroad company, the goods might be offered to the railroad as an agent authorized to receive the goods. It is safer, however, to offer them to the party himself, as then no question can arise as to the validity of the tender.

Where there are bulky goods, the person desiring to make the tender may ask the other party to name a place where they are to be delivered, and, if he fails to do so, may notify him that the goods will be delivered to him at a certain time and place most convenient for that other party. Then delivery at that time and place will be good tender although the other party is not there to receive the goods.

§ 77. Time to Tender Performance

The tender must be made at the exact time specified in the contract, and before sunset on that day, in order to give the other party a chance to examine the goods, etc. A tender

before the time for performance has arrived does not meet the requirements for a tender and will not save the rights of the party making it. If the contract specifies "on or about" a certain day, or "within" a certain time, a tender made a few days before the day set would be good. If a party cannot make the tender before sunset because the other party has remained away all day, he may make it as soon as the other party returns.

If a party positively states that he will not accept a tender under any circumstances, or has the party making it put off his premises, or refuses to hear him, it is not necessary to make the offer. The party from whom tender is due may explain to the court, and will be excused. Unless it is absolutely certain that it will be impossible to make a tender, however, the party should at least try to make it. Only the absolute certainty that the attempt would be useless will excuse him.

§ 78. Extent and Kind of Tender

The exact amount of goods or money called for by the contract, including any interest due, and, if the other party has begun an action or suffered any damages, his expenses or the damages due, also must be offered. If it is money, the party should take care that it is in "legal tender." This really means, as a usual rule, that too much small change should not be offered. Five-cent pieces are a legal tender up to \$5 and not over, while silver coins less than one dollar are a legal tender up to \$10 and not over. United States treasury notes, gold coins, and silver dollars are a legal tender to any amount. Ordinary bank notes are not legal tender, but, unless objected to at the time, a tender in bank notes would be good.

If it is not possible to ascertain the exact amount, the party should take care to offer more than enough, as too little will not make a good tender.

If the contract called for services, the tender will consist of notifying the other party that the party is ready and willing to perform the services whenever required.

A tender must be made unconditionally. The party must simply offer what is due without calling for anything in return, not even a receipt or change, or it is not a good tender. In all cases the party making the tender should be accompanied by a competent witness.

A tender is held to be vitiated by coupling it with a demand for a receipt for the sum offered, unless, as is the case in a few jurisdictions, a statute exists which allows the demand for a receipt.¹

§ 79. Acceptance of Tender

If a party keeps property or money that has been left with him after he has had a sufficiently long time to examine and refuse it, it amounts to an acceptance of the tender. If he refuses to accept, the party making the tender may take the goods or money away, and inform the other party that he will hold them subject to his orders; he will then keep the goods or money separate from his own property and ready at all times for the other party if he calls for them. If the money is deposited in a bank, it must be put in a separate account and not drawn upon.

REVIEW QUESTIONS

1. What is "tender" in legal phraseology? When must tender be made? What will excuse tender?
2. To whom may tender be made, other than to the contracting party himself?
3. What is the rule as to the amount tendered?

¹ 38 Cyc. 154.

4. What constitutes acceptance of tender?
5. What kinds and amounts of money are "legal tender"?
6. What proofs should be secured of fact of tender? Can a receipt for the amount paid be demanded?
7. If tender is refused, what may party making tender do?

CHAPTER XIV

JOINT AND SEVERAL CONTRACTS

§ 80. Contracts Made by More Than Two Parties

Very frequently we find contracts to which there are more than two parties; and these may be of two kinds, namely, what is known as a *joint contract*, in which all the parties on one side agree to be liable together for what is promised in the contract, each one being bound for the whole; or a *several contract*, where each of the parties agrees to be separately liable for his part. In some cases parties agree to be both jointly and separately liable, and then the person with whom the agreement was made has his choice of holding all of them liable together or each one liable separately.

It is unwise to become involved in a joint contract. Where the parties to a joint contract are liable:

1. Each is liable for the whole.
2. They must be sued together, not separately.
3. Where one dies he drops out, and the remainder are liable. If all died, the estate of the last decedent would be liable.
4. If one party is released, all are released.

Where the contract itself does not expressly state whether the parties are to be liable separately or all together for the whole contract, the court decides the nature of the contract from the probabilities of the case. If the promise by two or more is in the plural, the contract will be held joint, unless by the whole agreement the intention appears to hold them severally. For instance, the ordinary subscription agreement

is a several, not a joint, contract, and no one would imagine that each party who signed expected to be held liable for the whole amount to be raised.

Where, instead of being an agreement by several parties to do something, the agreement was to do something for the benefit of several parties, the test as to whether it is a joint or a several contract is whether the agreement has to be performed for all of them together, or whether it can be performed for each one separately. Wherever two or more are jointly to benefit by a contract, (1) all must join to bring suit on the contract; (2) if one dies the survivors have the legal right to sue. If it is a contract made to a corporation, the corporation will be regarded as one person; but all the members of a firm will have to join in any suit on such a contract.

If, on the contrary, it is an agreement to perform services for several persons as individuals, it usually amounts to a separate agreement with each of the individuals, and each of them may bring suit to enforce the agreement with the first party without paying any attention to the other persons.

Where there is more than one person on either or on both sides of a contract, it should be stated in the contract whether their obligation is joint or several, or whether the obligation to them is jointly or severally. To do so will save much trouble in enforcing the contract, as, if a person brings suit on a joint contract against one person only, he releases all the rest of them from their obligations; while, if it were a several contract, he may bring suits against one after the other until he has managed to collect the entire amount due him.

If one of the parties to a joint contract pays the whole obligation, he may collect from the others who were bound with him their proportion of the amount he had to pay.

Notes:

1. Where it was clearly not the intention of the parties to be liable for each other, the contract is several.

2. Where their interest is identical and in the whole contract, it is joint.
 3. Where they intend to be both jointly and severally liable on the whole contract, the contract is joint and several.
 4. A joint contract must be enforced by or against all of the parties to it.
 5. A party to whom others are jointly and severally liable may sue all of them together, or he may sue one at a time.
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REVIEW QUESTIONS

1. What is a joint contract? May more than two parties contract severally?
 2. What is the liability of a person who is party to a joint contract?
 3. If two or more parties sign a bond beginning "We, the undersigned, are held and firmly bound," etc., what kind of contract is it?
 4. A note begins, "Ninety days after date, we or either of us, promise to pay," etc. What kind of contract is it?
 5. Distinguish between a joint and a joint and several contract.
 6. What may a person do who has been forced to pay the whole amount on a joint contract?
 7. Give examples of contracts that are either joint, several, or joint and several.
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PART III
SALES

CHAPTER XV

CONTRACTS TO SELL¹

§ 81. Sales and Contracts to Sell

A sale is a completed transaction. The ownership of the goods has passed from the seller to the buyer, even though the seller may still hold the goods in his possession and the price may not yet have been paid.

There is no substantial difference between a sale and an exchange or barter, and the term "sale" is frequently applied to the latter transaction. But a technical sale is a transfer for a consideration in money, while an exchange or barter is a transfer of property for other property.

A contract to sell means that the ownership of the goods is to be transferred at some time in the future.

The definitions given in the Uniform Sales Act are as follows:

A sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration, called the price.

A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration, called the price.

The distinction between a contract to sell and a sale is this: in a contract to sell the goods are not delivered and title does not pass; while in a sale delivery is made or the title passes. A contract to sell is an executory contract. A sale or a bargain and sale is an executed contract. A sale is the transfer of the property or the thing from the seller to the buyer for

¹ For forms of sales contracts, see Chapter CI, Forms 20-25.

a price. The Statute of Frauds applies only to contracts to sell. (See § 102.)

§ 82. Uniform Sales Act

On account of the confusion of the law in regard to commercial transactions, commissions have been appointed by the various states to unite in working out uniform laws governing such transactions. Largely as a result of the activities of these commissions, two laws have been passed by many states: (1) The Uniform Negotiable Instruments Law has been adopted in all of the states and territories with the exception of Georgia and Porto Rico. (2) The Uniform Sales Act has been adopted in the following states:

Arizona	New Jersey
Connecticut	New York
Idaho	North Dakota
Illinois	Ohio
Iowa	Oregon
Maryland	Pennsylvania
Massachusetts	Rhode Island
Michigan	Tennessee
Minnesota	Utah
Mississippi	Wisconsin
Missouri	Wyoming
Nevada	Territory of Alaska

The object of these acts is not to change, but to combine, the best features of the existing laws of the different states. In some cases the states have adopted these acts with slight modifications, but for all practical purposes the law is uniform.

§ 83. What Is Necessary to the Contract of Sale

A contract of sale (or contract to sell) must have the same elements as any other contract. In other words, there must be:

1. Parties who are competent to contract.
2. An agreement between those parties.
3. Consideration for the agreement.
4. A legal contract.
5. A subject matter.

These elements have all been explained at length in the preceding chapters relating to contracts in general. (See Part II.) A few peculiarities which concern sales alone will be taken up in the following sections.

Note:

1. A sale is completed when the goods are transferred, but, if the buyer was not competent to make a contract, or the contract was illegal, the seller could not collect the price.

§ 84. The Agreement

This has been fully explained under contracts (§ 42). In the sale and in the contract to sell, there must be the proposal of terms on the one hand, and the acceptance of those terms on the other.

Notes:

1. To make a legal sale, there must be an agreement of the parties *which can be proved*.
2. A written contract signed by both parties is the best evidence of such an agreement.
3. A letter making an offer, which is accepted by another letter, is the simplest form of written contract.

§ 85. Sales to Persons Incompetent to Contract

The rules which have been laid down under the subject of contracts (§ 38) with regard to the contracts of certain persons who are by law made incompetent or are given only a qualified power to contract, apply also to the contract of sale.

The exception to the rules laid down, is an *actual sale* of (not a contract to sell) necessities. A person who sells necessities to a person who is not competent to make a contract may recover a *reasonable price* (not necessarily what he asked) for them. The Uniform Sales Act says that the goods must be necessary *at the time they are delivered*.

If a merchant furnishes necessities to a married woman or an infant, he may charge them (1) to the woman or the infant, or (2) he may charge them to the husband or the father. He cannot charge them to both. He must make his choice and afterward bring suit against the party charged.

In this country necessities include only food, clothing, and shelter of a grade suited to the means of the person to whom they are furnished; and in this connection it is well to bear in mind that such things as riding horses and automobiles are not necessities.

Notes:

1. In supplying necessities to a minor or a married woman the merchant should inquire (1) whether the incompetent person is already provided; (2) whether he or she has any property from which a claim for necessities could be collected.
2. If the incompetent person is an infant or a married woman, and the merchant desires to charge the amount to the father or the husband, he should inquire as to his credit.

§ 86. The Consideration

A sale or a contract of sale which did not name a price might still be good, because the court which was asked to enforce it would assume that the goods were to be paid for at a reasonable price and charge the buyer accordingly. The price fixed may be dependent on outside circumstances that would affect it, as for instance the market price at the time and place of delivery.

The general question of consideration has been very fully discussed under "Contracts" (§ 44)..

Note:

1. Parties in making a sale should agree on the price.
Neither the seller nor the buyer may be satisfied with what the law will consider reasonable.

§ 87. Nature of Subject Matter

A person might make a contract to sell a crop which he had just planted, or grass which might grow in the future on land which he owned, or chickens to be hatched from eggs which his hens might lay; but if he had not the land or the hens, he could not make a contract to sell grass on land which he might buy in the future, or eggs from hens which he might later acquire.

Goods which are already in existence and in shape to be delivered may be contracted to be sold, and also:

1. Goods which still require some process to render them ready for delivery; i.e., cloth to be made by a tailor into a suit.
2. Goods to be acquired by the seller in the future; i.e., a commission merchant selling so many dozens of eggs which he has yet to buy from the producer.
3. Goods which may or may not be acquired by the seller in the future, depending on the happening

of some condition; i.e., the same commission merchant selling so many dozens of eggs provided that he can obtain that number from the producers.

4. An undivided share in goods; i.e., a tenth part of a crop of wheat.
5. A definite number, weight, or measure of goods in mass; i.e., a bushel of oats out of a bin of oats.

Under the Uniform Sales Act, the goods mentioned in 1, 2, and 3 cannot be the subject of a sale, but only of a contract to sell, since they are not yet in shape to deliver.

§ 88. Destruction of Subject Matter

When the goods which the seller is offering for sale have been entirely destroyed without his knowledge at the time the agreement is entered into, the contract of sale does not take effect. When they have been partly destroyed, the buyer may refuse to take any of them, or he may take those which are left and pay the full price which was agreed upon. In the last case, if the price was divided up, as so much a quart, a barrel, etc., he may pay for what he gets. If there was one lump price named for the entire lot, he must pay the entire amount, because the court will not attempt to split it up for him. To do so would be to make a new contract for the parties.

If there has been an actual sale and the ownership of the goods has passed to the buyer, the loss falls on him if they are destroyed without fault of the seller, even though they remain in the seller's possession. If the ownership still remains with the seller, the loss would fall on the seller, wherever the goods may be, even though on their way to the purchaser.

Goods are sometimes sold with the privilege of returning if not sold at a certain time. In such a sale the title passes and in event of destruction by fire, the buyer would lose. The agreement to take the goods back is a condition subsequent.

The case is to be distinguished from that in which the goods are sent on consignment. (See § 93.)

Where the contract was not for any specific articles, but only for so many feet of lumber, bushels of wheat, etc., the destruction of the wheat or lumber which the seller had at the time the contract was made would not excuse him from performing it. He must go out and buy more to replace what was lost.

Note:

1. The agreement of sale should be very definite as to the time when the ownership is to pass from the seller to the buyer. Much may depend on this fact.

§ 89. Sales to Arrive

Contracts are made at times for the sale of specific goods to arrive on a named ship. This arrival is a condition precedent. If the goods do not arrive, or if they arrive on another ship, the contract is nullified.

§ 90. A Contract of Sale Must Be Legal

Every contract must be legal to be enforceable. A contract for the sale of liquor in a prohibition state could not be enforced, and, if liquor had been sold, the seller could not recover the purchase price. This is also true where a license is required to sell any particular commodity. An unlicensed seller could not collect. (See general discussion of illegal contracts, §§ 39, 57.)

Note:

1. Where there has been an illegal contract, the courts will leave both parties just where they found them, and refuse to help either.

REVIEW QUESTIONS

1. Distinguish sale and barter. Distinguish between a sale and a contract to sell.
2. Why is it important to know whether a particular contract is an executed or an executory sale?
3. Why are uniform sales laws desirable? Has the Uniform Sales Act been adopted in your state?
4. Can there be an executed sale of articles not in existence?
5. When a seller ostensibly makes a present sale of goods which are not then in existence, what is the effect on the contract?
6. If goods sold are partly destroyed at time of sale, what right has the buyer?
7. If the sale had been executed before the damage happened, what would be the rights of the parties?
8. Give meaning and legal effect of a sale to arrive.
9. B made sales, without a license, of kerosene and liquor. Can these accounts be enforced against the customers?
10. A, a retailer, bought goods of B with the understanding that unsold goods would be taken back at the end of the season. Fire destroyed the goods without fault of A, while in A's possession. Who bears the loss?

CHAPTER XVI

PASSING TITLE

§ 91. Delivery

In a sale—not a contract of sale (see § 81)—the delivery is made at the time, and there is no question in regard to the passing of title from seller to purchaser. The delivery may consist in merely setting aside the goods for the new owner, but the title passes, and, if the goods are afterwards destroyed, the loss is the purchaser's. In one case delivery consisted in giving the purchaser the key to the building where some machinery was stored.¹

A flood or a railroad accident which delays the delivery of goods is not an excuse for failure to perform a positive contract. It is a general rule that, where an engagement to do a certain thing is positive in its terms, an accident, or change of conditions, will not excuse performance. The Japanese, it is said, look at this matter exactly the other way, and say that if conditions change after a contract has been made it would be unjust to compel performance.

§ 92. Selection Necessary to Delivery

It is impossible to transfer the ownership of goods that have not been identified or set aside. A contract to sell an automobile of a certain make does not transfer the title to any automobile until a particular automobile has been designated as the subject matter of the contract. The precise article or articles that are to constitute the subject matter of the sale must be agreed upon. This means that the subject

¹ *Kellogg Newspaper Co. v. Peterson*, 163 Ill. 138.

matter of the sale must have been selected. Usually the selection is made by the buyer, but in some cases the buyer directly or indirectly authorizes the seller to make the selection for him.

In the case mentioned in heading 4 under § 87, where there is the sale of an undivided interest in goods, no actual delivery or selection is necessary. By the sale, the purchaser acquires whatever the seller's rights were in the whole. If the seller had the right to have his share taken out of the mass, the buyer would have the same right; if the seller had a right to a proportionate share only in the price received when the goods were sold, the buyer would get only the same right. The time, present or future, when the title will pass depends on the agreement.

In a contract to sell, the time for the title to pass depends on the contract; if the intention of the parties is clearly expressed, it passes at the time they have fixed upon. The rules given in the next section will determine when it passes in case the intention is not clearly expressed.

Note:

1. Any act which the parties intend to represent delivery of the goods will be a sufficient delivery. If a suit of clothes has been selected and set aside for the purchaser, it becomes at once his property.

§ 93. When the Title Passes

The following are rules for determining the intentions of the parties as to the time at which the title passes, i.e., at which the buyer becomes the owner:

1. Where goods are picked out and are in the shape in which they are to be delivered at the time the contract is made, the buyer becomes the owner at that time.
2. When the goods have to be picked out, or something

further remains to be done to them before they can be delivered, the buyer does not become the owner until that is done.

3. When a contract is made to sell a certain number, weight, or measure of goods, or goods to be acquired in the future by the seller, the buyer becomes the owner after goods answering the description in the contract are turned over to him, or he takes possession of them.
4. (a) When goods are delivered "on trial," or "on approval," the buyer becomes the owner upon their delivery. He may, however, cease to be the owner and make the seller again their owner by returning them or notifying the seller within the time specified in the contract, or a reasonable time if none was specified, that he will not accept them.
(b) When the buyer lets the time fixed for the return of the goods pass without returning them, or keeps them beyond what is a reasonable time under the circumstances, or signifies his approval and his intention to keep them either by words or acts, he becomes their permanent owner.
5. If the agreement requires delivery to the buyer at a particular place, or payment of freight to the buyer or to a particular place, the title does not pass until the goods have reached the buyer or the place agreed upon.
6. When goods are to be manufactured the title does not pass until they are completed and delivered to or accepted by the party who ordered them.
7. If goods are ordered and shipping directions are given, delivery is made when the goods are delivered to the railroad or other means of transport. After that they are the property of the buyer.

Note:

1. A contract to sell should specify precisely when title to the goods is to pass.

§ 94. Sales Without Delivery

Whether or not there has been a legal delivery such as described in § 91, it is always a risk to leave property in the seller's possession. In those states where the Uniform Sales Act has been adopted, the law makes a seller who has the goods left in his possession the agent of the buyer to sell, pledge, or otherwise dispose of them. The very fact that the property is in the possession of the seller is likely to mislead innocent third parties who have no notice of the sale. If the seller was dishonest enough to sell the property again, there would be no chance of recovering it from any third party to whom he sold or pledged it. This is likewise the case in California, Colorado, Kentucky, Maine, Montana, Oklahoma, South Dakota, Vermont, and Washington. The laws in the states enumerated above regard leaving the property with the seller as opportunity for fraud on other persons; hence the party who so left the property must lose, if the goods are sold to an innocent buyer. This is just, as, if a man has property in his possession it is fair to assume that it is his, and if he sells it again, the new buyer should be protected.

In other states, the court will presume that leaving the property with the seller amounts to a fraud, but the first buyer may prove that the sale to himself was a real one, made in good faith, and not a mere sham for the purpose of cheating anyone, and in this way may recover his property. If it can be shown in any case that there was no real sale, but only a pretended one, a creditor of the seller may treat the goods left with the seller as belonging to the latter and levy on them in payment of his claim.

Where for any reason possession is to be left with the seller, the only safe method for the buyer is to take a formal bill of sale and to file it on record in the proper office of registry for the locality.

Notes:

1. If a sale is made the seller should not keep the goods.
2. If the seller is allowed to keep the goods and sells them to an innocent buyer, the first buyer ordinarily loses.

§ 95. Conditional Sales

It is possible for the seller to give the purchaser possession of the article that has been sold, and still to retain the ownership himself until the full price or a certain amount of the price has been paid. This can be done only by agreement, however, and where sales are made on the instalment plan it is very common to provide in the agreement of sale that the ownership shall not pass from the seller to the buyer until the last instalment has been paid. Such sales are known as "conditional sales."

The law always enforces such an arrangement as between the buyer and the seller. For the sake of ready proof and avoidance of misunderstandings, the contract should be in writing and must be so expressed in many states. A common plan is for part payments to be made as rent, with a proviso that the title passes to the purchaser when the last instalment is paid.

The difficulty arises from the fact that, as the buyer has the property in his own possession, third persons are likely to be misled into believing that he owns it and has the right to dispose of it. Most of the states get around the difficulty by providing that the seller must file the contract in an office of public record. Everybody is then required to know that it exists, as in the case of a mortgage. If the seller does not

put the contract on record, and the buyer is dishonest enough to dispose of the property to a third person who had no knowledge of the seller's rights, the seller loses the property in the majority of instances.

§ 96. State Laws on Conditional Sales

In the following states conditional sales are good against third parties without acknowledgment or filing in any public office:

Arkansas	Nevada
California	Rhode Island
Idaho	Tennessee
Indiana	Utah

The District of Columbia, Massachusetts, Oregon and Louisiana have substantially the same law with a few exceptions.

In the following states the contract recorded is merely signed by the purchaser:

Alabama	Montana
Kansas	New York
Maine	Oklahoma
Maryland	Texas
Minnesota	Vermont

West Virginia

In some of these states more formality is required if the contract is for the sale of railroad equipment.

Those states which demand a record require different formalities in order to permit the contract to be put on record.

§ 97. Requirement of Affidavits to Conditional Sales Contracts

Some states require an affidavit by the seller stating certain facts of the sale. These are Michigan, Nebraska, New

Hampshire, Ohio, Pennsylvania, and Wyoming. In others, if the signature to the contract is attested by a witness, the witness may prove it, and it is then admitted to record; very few of the states require that the contract shall be acknowledged in person by the buyer. Colorado, Connecticut and District of Columbia require acknowledgment where the sale is over \$100 in amount. In Iowa it may be acknowledged by either the seller or buyer and is then entitled to be admitted to record; while in Florida the seller must acknowledge in person, or his or its signatures must be proved by one of two subscribing witnesses.

§ 98. Rights in Illinois and Pennsylvania

In Illinois the rights of the seller under a conditional sale will not hold against a third party to whom the buyer may have sold the goods. The seller may protect himself, however, by taking a chattel mortgage on the article sold and recording that. In Pennsylvania where the property is not attached or to be attached to realty, the seller makes a contract to lease the property, the purchaser to pay a regular rental instead of instalments and to give back the property at the end of the rental period. Then a clause is added giving the purchaser the right to elect to keep the property instead of returning it at the expiration of the lease. Where the property covered is attached or to be attached to realty, then either a conditional sale contract or a lease with option to purchase may be used, but it must be recorded with an affidavit.

§ 99. Protection Against Landlord's Lien

In those states where a landlord has a lien on property in rented buildings, the contract of conditional sale should be recorded before the property is moved into the building in order to protect it against his lien.

If fixtures such as gas and electric chandeliers, etc., are

sold under a contract of conditional sale, they will be protected by recording the contract and may be removed as readily as any other personal property. If, however, the property sold was afterwards attached to the building itself and could not be removed without injury to it, such as a mantel or built-in china closets and book-shelves, the only remedy which the seller has is to claim a lien against the building for the amount due him.

§ 100. Protection Against Destruction of Property

Where the property is destroyed while it is held under a contract of conditional sale, the decisions are in conflict. In some states the buyer loses; in others the seller; and in other states the matter has not been decided. Usually, under such circumstances, the buyer refuses to make further payments but may be held liable for the value of the goods. Unless the buyer can afford such a possible loss, it is prudent to provide for insurance.

Notes:

1. If a sale on condition is to be made, and the value of the article justifies it, a lawyer should be employed.
2. If articles are to be sold on instalments in different states, the laws of each must be considered and much care will be required in making the contract.²

REVIEW QUESTIONS

1. When does title pass in "a sale"?
2. When does title pass under a sale "on trial" or "on approval"?
3. When does title pass when goods are manufactured under order?

² The standard authority on this general subject is Haring's "Conditional Sale Laws," published by the author, Fred Benson Haring, Buffalo, N. Y.

4. When does title pass when goods are ordered to be shipped by rail?
5. If the buyer desires to leave the goods he has bought with the seller, how can he protect his title?
6. If the buyer after taking title leaves the goods with the seller, who sells them to a third party, does the third party take good title in your state? What recourse would the original buyer have?
7. How can the seller part with possession and yet keep title? What is such an arrangement called?
8. In your state what is the law as to conditional sales?
9. In your state if a farmer bought a binder on instalments and it was burned down when he had paid but half the purchase price, whose would the loss be?

CHAPTER XVII

THE STATUTE OF FRAUDS

§ 101. Description of the Statute of Frauds

The English law known as the Statute of Frauds was passed in 1676. Part of this famous law has been examined in § 48. The part we are here concerned with is the seventeenth section, which in some form has been enacted in most of the states and is as follows:

No contract for the sale of any goods, wares and merchandise, for the price of ten pounds sterling or upward shall be allowed to be good; except the buyer shall accept part of the goods so sold and actually receive the same, or give something in earnest to bind the bargain or in part payment, or that some note or memorandum in writing of the said bargain be made, and signed by the parties to be charged by such contract or their agents thereunto lawfully authorized.

The Statute of Frauds applies to contracts to sell, not to sales.

"Goods, wares and merchandise" are held in this country to include all that is usually classed as personal property, goods, chattels, and *choses in action*, i.e., accounts, claims, contracts, stocks, and securities.

A contract for the sale of corporate stocks or bonds is good if some memorandum is made by the broker before suit is brought.

§ 102. Contracts to Sell

The definition in the Uniform Sales Act is given as follows:

A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration called the price.

The distinction between a contract to sell and a sale is this: in a contract to sell, the goods are not delivered and title does not pass; while in a sale, delivery is made or the title passes to the purchaser.

§ 103. When the Contract of Sale Must Be in Writing

The Statute of Frauds discussed in § 101 applies to contracts of sale where delivery is to be made later and where the value is over a certain amount. This amount ranges from \$30 in Arkansas, Maine, and Missouri, to \$500 in Arizona, Massachusetts, New Jersey, Rhode Island and \$2,500 in Ohio. Fifty dollars is usual.

The words "in value" apply where the Uniform Sales Act has been passed. In the old statute, the words were "in price." The price is the amount fixed by the parties themselves; the value, what the goods are actually worth in the market. For this reason, contracts purely by word of mouth have become more risky under the Uniform Sales Act. In order that a contract of sale above the limited amount may be enforceable, a written memorandum of the terms of the agreement must be signed by the party against whom it is sought to enforce the contract, or his agent.

The written memorandum of sale required by the Statute of Frauds need not be formal. It may be a note, a letter, a telegram, a receipt, or may consist of several papers so connected as to make an intelligible sales-contract. The written memorandum of sale need not be made at the time of the contract, but it must state all the material facts, the parties, the price, if a price was agreed upon, and specify the articles to be sold. It must be signed by the party, or by the agent of the party whom it is desired to hold. In states where the Uniform

Sales Act does not prevail, the written memorandum of sale may have to be subscribed; that is, signed at the end of the contract.

Exceptions to the rule that a sale of goods above the limited amount must be in writing, occur: (1) when the buyer has paid part of the price, or (2) where the buyer has accepted and actually received part of the goods. The last two methods of satisfying the statute will be considered in the following sections.

Notes:

1. Any contract of sale above the specified minimum must be in writing.
2. All contracts should be in writing.

§ 104. Exception for Part Payment

A payment made at the time of entering into the contract of sale makes it enforceable, though it may be above the limited value. The payment may either be a part of the price, or something given or paid to "bind the bargain." This should, strictly speaking, be in addition to the purchase price. In England this earnest is no part of the price of the goods. Usually in this country it is part of the price. The amount is not material.

The thing delivered in part payment must be of some value, but if of any value at all, it will be sufficient to bind the bargain.¹

Note:

1. Part payment will bind the bargain, but it is no evidence as to time, terms, and essentials of the agreement, and it is a poor substitute for a written contract.

¹ Weir v. Hudnut, 115 Md. 525.

§ 105. Exception for Part Delivery

The second case mentioned in § 103 was: "Where the buyer has accepted and actually received part of the goods." The word "received" means taken into actual physical possession, the word "accepted" means that the buyer must have determined in his own mind to become the owner of the goods. Both conditions must be fulfilled to make the contract enforceable. The buyer may show his consent to become the owner of the goods either by his words or by his conduct.

The "part of the goods" must be taken out of the actual amount of the goods to be delivered. Samples or specimens which do not come out of the buyer's share are not "part of the goods."

If the buyer has directed the goods to be delivered to a railroad company for transportation, a delivery to the railroad company is a delivery to him and their receipt for the goods will be his receipt. If he has not so directed, there is no receipt and acceptance until the buyer or his agent accepts the goods from the railroad company.

Note:

1. Although he may have accepted the goods, the purchaser could still dispute the price, the warranties, and the other terms of the agreement. The written contract is the only dependable means of proving the agreement.

§ 106. Exception for Amounts Below Specified Value

Contracts of sale below the minimum established by the law need not be in writing. If the transaction were below the value set in any particular state, suit could be brought on an oral contract; i.e., a contract not in writing. If it were proved, it could be enforced, but an oral contract is always hard to prove. (See § 46.)

If the contract of sale is above the minimum value, suit cannot be brought upon it unless it is in writing. If the parties to such a contract (not in writing) carry it out, it becomes an executed sale and stands, as does any other sale, but if either party refuses to carry it out, the other cannot enforce it at law.

A single contract for the sale of a number of articles, each of which is below the limited amount in value, must nevertheless be in writing if the value of all together is greater than the limited amount.

Notes:

1. It is safest to make all contracts in writing.
2. Any contract of sale above the specified minimum *must* be in writing except in cases of part payment or part delivery. Any contract of sale below the minimum *should be* in writing.
3. It is never safe to enter into any contract without some memorandum in writing. Especially is this true when there is anything indefinite about the possible value of the goods to be sold.

§ 107. Exception for Work or Services

If the article purchased involves work or services which make it suitable only for the original buyer, the contract may be oral. For example, a man goes to a dentist and orders a set of false teeth. The dentist takes some porcelain and other materials worth very much less than \$50 and out of them makes a set for which he charges considerably over \$50. His work and skill are what give the teeth their value, and the teeth which are made for one man cannot be sold to another. In such a case the law says it is the dentist's services, not the materials, for which the man is paying, and the contract is not one of sale and need not be subject to any of the conditions mentioned in § 103. That is, the dentist can bring suit without a written contract.

If the article to be made is something which can be sold to someone else, the contract is one of sale and must satisfy the requirements of the Statute of Frauds.

The foregoing is a statement of the law where the Uniform Sales Act applies. There have been two other views of the case: one of them, the English rule that if any article was to be made as a result of work and services, the contract was one of sale; the other, the former New York rule, that if there was any work to be performed on the article, the contract was not a sale but for work and services, and the Statute of Frauds did not apply to it. Either of these two rules may still apply in a state which has not adopted the Uniform Sales Act.

Note:

1. Have a written contract in all cases where the price is more than you can afford to lose.
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REVIEW QUESTIONS

1. Distinguish between a "sale" and "contract to sell."
2. Has the Uniform Sales Act been adopted in your state?
3. In your state what is the amount over which contracts must be in writing? Must this amount be "in value" or "in price"?
4. Who must sign the memorandum required by the Statute of Frauds? Why should both parties sign?
5. When should the memorandum required by the Statute of Frauds be made and what should be its form?
6. What exceptions are there to the rule in the Statute of Frauds as to the written memorandum?
7. What is the rule in your state as to contracts for work and services?
8. What are "goods, wares and merchandise" within the meaning of the Statute of Frauds?

CHAPTER XVIII

WARRANTIES¹

§ 108. Introductory

The definition of a warranty in the Standard Dictionary is:

An assurance or undertaking by the seller of property, express or implied, that the property is or shall be as it is represented or promised to be, as to quantity, quality, or title.

If a farmer goes into an agricultural warehouse and asks to look at mowing machines, and after having inspected the stock and obtained prices to his satisfaction, says he will take the one which he has selected, he has assumed the responsibility for its fitness himself and has no recourse as to the seller for damages afterward if it should prove unsatisfactory. The court would apply the maxim *caveat emptor*, the ancient and harsh doctrine of the common law, signifying, "let the buyer beware." The common law took a sporting view of the dealings between buyer and seller, and did not wish to discourage skill in barter by stressing too much any ethical considerations.

At the present day, however, both law and trade morality have advanced a long way beyond this primitive conception of the rights of buyer and seller. Nearly all trade transactions are now based on certain contract conditions, expressed or implied, by which the risk to the buyer is largely eliminated. A change of property for a consideration rarely takes place

¹ For form of warranty contract, see Chapter CI, Form 25.

without some conditions or warranties as to quality, utility, or other characteristics of the commodity sold.

Note:

1. The buyer should take care that he has a warranty that what he purchases will serve his purpose.

§ 109. Conditions Precedent

An agreement that an article must be up to a certain standard is known as a condition precedent.

A condition precedent is a specification of the kind of article that is wanted with which the article must comply before there can be any sale at all.

If it is agreed that the article to be sold is to conform to a certain standard, there is no sale until an article is produced according to that standard. For instance, if the seller agreed to furnish a steam pump that would raise 100 gallons a minute to a height of 50 feet, he must furnish a pump that will do exactly this before the buyer is obliged to take it.

Another example of a condition precedent occurs in a provision that work to be done or goods to be delivered must be satisfactory to or approved by some third party, as when a church organ is installed, to be approved by some musical expert.

All executory contracts are, in fact, contracts with performance as a condition precedent to payment.

Note:

1. Where there has been an agreement that the article to be sold shall be of a certain kind and quality, the buyer is not obliged to take any article that is not of that kind and quality.

§ 110. Conditions Subsequent

A condition subsequent is a condition that may defeat the sale after its completion, and give the buyer the right to return it and recover the price if he had paid for it.

The technical distinction between a condition subsequent and a warranty has been wiped out by the Uniform Sales Act. Formerly, a breach of warranty entitled the injured party only to damages, while a breach of condition gave him his choice of suing for damages or returning the goods. By the Uniform Sales Act the buyer who suffers a breach of warranty now has the same choice of remedies that the buyer who suffers a breach of condition has always had. Wherever this act is in force the buyer, whether under warranty or under condition, has his choice of suing or of returning the goods.

§ 111. Express Warranties

An express warranty is a statement made by the seller about the quality, durability, working ability, etc., of the article sold in order to induce the buyer to purchase. The purchaser must have bought the goods in reliance on that statement. If he relies on his own judgment and selects the goods himself, there is no warranty even though the seller makes a statement of fact.

Any statement of fact or any promise by the seller in regard to the quantity, quality, or title of a commodity is an express warranty, if the natural effect of such a statement is to induce the buyer to purchase the goods, and if the buyer does purchase the goods relying on such statements.

If there is a warranty, and upon using the goods it turns out to be untrue, under the Uniform Sales Act the buyer may return the goods, or he may sue the seller and recover damages in the amount of the difference between what the article is actually worth to him and what it would have been worth had the warranty been true. (See § 114.)

If a merchant tells you that his goods are the best on the market, this is not an express warranty, as it amounts merely to his opinion of them, and is what is called "merchant's puffing." If, on the other hand, he makes an express statement that these goods will wear better than certain similar goods manufactured by another firm, you may rely on his statement as an express warranty.

It is always well to get a warranty in the most definite terms possible, for if a merchant is really willing to warrant his goods he will not be afraid to say so in plain language if the buyer insists upon it. If the merchant is not willing to make a definite warranty, it is better for the buyer to know it beforehand and to realize that he is relying on his own judgment and can claim nothing from the merchant in case the goods prove unsatisfactory. A written warranty prevents forgetfulness on the part of the seller.

Notes:

1. In all purchases, make sure that all terms are plainly written out, in positive language.
2. In all prospectuses, analyze the statements and note the positive assertions as to material matters.

§ 112. Implied Warranties

In every sale today there are certain implied warranties which the law compels the seller to make good. In regard to his right to sell the property, he warrants by the mere act of selling goods:

1. That he has a right to sell the goods, or, if it be a contract of sale, that he will have the right to sell them when the time for the sale arrives.
2. That the buyer shall not be disturbed by any claims made by others against the goods.

3. That the goods are free from any claim, charge, or incumbrance at the time of the sale.

These warranties do not apply to sheriff's sales and auction sales. There the buyer takes the risk that the article may be claimed by someone else.

If the seller sells stolen goods, the buyer will be forced to return the goods to their rightful owner, but he may, if he can, recover from the seller the damages which he has suffered because of the sale.

Special Situations. There is what seems to the public a curious situation here. If the seller had actually stolen the goods, the buyer would have to give them up to the rightful owner even though he knew nothing of the theft; whereas, if the seller had obtained the goods with the consent of the rightful owner through fraud, the buyer, ignorant of the fraud, might be allowed to keep them. There is a case where a man bought some jewelry on credit by representing himself to be another man, and afterwards sold the jewelry to a third person who had no knowledge of the fraud, and the third person was allowed to keep the jewelry. This is because the jeweler gave up the property of his own accord to the fraudulent seller and therefore enabled the seller to lead the third person into buying the jewelry and paying out his money for it.

Other Implied Warranties. There are two other warranties which go with a sale of goods even though nothing is said about them.

1. If the buyer makes known to the seller the purpose for which he intends to use the goods, or if this purpose was known to the seller, there is a warranty that the goods are fit for the purpose.

Whenever a person goes into a market or a grocery store to buy food, the butcher or the grocer is supposed to know

that he is buying it for the purpose of eating it and there is, therefore, a warranty that the food is fit to eat.

If the buyer orders goods by their trade-names (Quaker Oats, Ivory Soap, etc.), the seller is relieved from any warranty that they are fit for his purpose.

2. If goods are bought from a person who regularly deals in that kind of goods, there is a warranty that they are of merchantable, that is, salable quality.

When a person orders goods from a description in a sales catalogue, or from a sample, there is also an implied warranty that they are similar to the description or sample.

The seller is liable in damages to the buyer if any of these warranties are broken. He is liable only to the *immediate* buyer, however, and not to other persons to whom the buyer sells the goods, although he may, if he manufactured the article himself, be liable for any injuries suffered as the result of a defect in it.

Note:

1. The fact that the law implies certain warranties should not prevent the buyer from obtaining positive written warranties on all important purchases.
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REVIEW QUESTIONS

1. What is a warranty?
2. Is a warranty of quality of a chattel implied by the mere fact of sale? What is the rule?
3. Distinguish a condition precedent from warranty.
4. Distinguish a condition subsequent from warranty.
5. May an injured party treat breach of a condition subsequent as a breach of warranty?
6. What two elements constitute an express warranty? Distinguish between a "statement of fact" and an "expression of opinion."

7. What are the implied warranties of ownership where a sale is made? What are the implied warranties of quality?
8. To what classes of sales do the implied warranties of ownership not apply?
9. Does a warranty follow the goods through successive sales? What exception is there to this rule?
10. To whom only is the seller liable for a breach of an implied warranty?

CHAPTER XIX

REMEDIES

§ 113. Rights of Unpaid Seller Under the Contract

The various sorts of warranties protect the buyer in all business transactions. It is necessary also that the rights of the seller be protected. Most breaches of contract in cases of sale arise from the failure of the buyer to make the required payments. In such cases the goods may be in the possession of one of the following three parties:

1. The unpaid seller may still have the goods in his own possession; or
2. They may be in the possession of a railroad, a steamship, or an express company for the purpose of shipment to the buyer; or
3. They may be in the possession of the buyer himself.

A seller is still unpaid if he has been given a bad check or note in return for the goods.

1. If the seller has the goods in his own possession, and if they were not sold on credit, any of the following courses is possible:

- (a) The seller may in most cases refuse to give them up until they are paid for. If, however, the sale is on credit, and the seller has no reason to believe that the buyer is insolvent, the seller's duty would be to deliver the goods.
- (b) If the goods are of a perishable nature, or if the buyer has failed to pay for an unreasonable length of time, or if the seller has reserved that right in his agreement of sale, he may resell them to

another person, keep the price, and sue the buyer for damages for any loss he may have sustained by the transaction.

- (c) The seller may, if the time for payment has arrived, notify the buyer that he holds the goods for him and sue him for the price.
- (d) The seller may, if the time for payment has arrived and no payment has been made, sue the buyer for damages for breach of the contract.

The measure of damages will be the difference between what the seller can sell the goods for to someone else, and the contract price. If the seller was manufacturing the article, he may claim damages for whatever loss he has sustained in time or otherwise up to the time the buyer notified him that he refused to take the article, *not* for any loss through continuing the work after that. Of course, if he can sell the article when finished to someone else at the same price, there is no loss.

If the goods were sold on credit, and the term of credit has expired while they are still in the seller's possession, or if the buyer has become insolvent, then the seller may exercise either of the last two rights.

2. If the goods have been delivered to a railroad company, etc., for transportation, the seller's rights may be summed up as follows:

- (a) If in giving the goods to the railroad company for transportation the seller reserves the right of ownership to himself, he may refuse to allow the goods to be delivered to the buyer until the latter pays the purchase price. The seller may keep control by shipping to himself at the destination. Then, until he assigns the bill of lading to the buyer, the control is in his hands.

- (b) If the buyer becomes insolvent and the goods are in transit, the seller may stop their delivery and enforce any of the remedies mentioned under (1), provided the railroad, express company, or other carrier, has not informed the buyer that they are holding the goods subject to his orders. The seller cannot, of course, stop the delivery of the goods after they are in the possession of the buyer or his agent, even though it was before they reached their destination. If there has been a bill of lading issued for the goods, the railroad company may refuse to give them up until the bill of lading is returned.

Until the goods have come into the possession of the buyer, the seller's right of stoppage *in transitu* is superior to any other claim. Other creditors have tried to attach goods under such circumstances, but the courts have always maintained the seller's priority unless the buyer himself had received them, or they had rightfully passed under his control. The buyer could not defeat the right of stoppage by selling the goods in transit to a third party. The third party would have the same rights as the first buyer and no more.

A seller who stops goods in transit on a mere *rumor* of the buyer's insolvency will be liable for damages if the buyer is really solvent.

3. If the goods have come into the possession of the buyer, they are his property and the seller has lost all claim to them. The seller can only bring suit for the price if it is not paid when due.

Note:

1. A provision permitting the seller to resell the goods in the event of non-payment before delivery should be inserted in the contract in those cases

where the buyer's credit is not dependable. This allows him to protect himself by selling them without running the risk of being held guilty of breaking the contract.

§ 114. Rights of Buyer

When a salesman sells goods to a customer, the employer has the right to refuse to accept the order of the customer, but, if the customer can prove actual damage, the employer will be liable to the extent thereof. By allowing the salesman to hold himself out as an authorized agent with the power of sale, the employer makes himself liable for his acts.

Where the seller refuses to give up the goods to the buyer, except where the buyer does not pay at the proper time (see § 113):

1. The buyer may have the right to the ownership of the goods. In this case he may sue the seller for damages for withholding the goods, or he may bring what is known as an "action in replevin" to get possession of the particular goods.
2. Or the buyer may have no right of ownership over the goods, but only a right under the contract to have the goods delivered to him. In this case:
 - (a) The buyer may sue the seller for damages for breach of the contract; or
 - (b) If the article was of a special kind or made to order so that he could not get it anywhere else, the buyer may go into a court of equity and sue to compel the seller to perform his contract.

The measure of damages in any of these cases is the difference between what the buyer could go out into the market and buy the goods for, and the contract price. If he

could get them for the same price or less in the market, he would, of course, have suffered no damages.

Where the seller delivers or tenders the goods but they fail to come up to a warranty which he has made for them, the Uniform Sales Act allows the buyer the following remedies:

1. He may accept or keep the goods and set up against the seller the breach of warranty by way of recoupment in diminution or extinction of the price.
2. He may accept or keep the goods and maintain an action against the seller for damages for the breach of warranty.
3. He may refuse to accept the goods, if the property therein has not passed, and maintain an action against the seller for damages for the breach of warranty.
4. He may rescind the contract to sell, or the sale, and refuse to receive the goods, or if the goods have already been received, return them or offer to return them to the seller and recover the price or any part thereof which has been paid.

When the buyer has claimed and has been granted a remedy in any one of these ways, no other remedy is thereafter granted.

The buyer must send back the goods in as good condition as that in which they were received, unless the damage has resulted because of the fact that they were not as warranted. He cannot return them if he has once accepted them knowing that they were not as warranted, or if he has failed to notify the seller within a reasonable time that he refuses to take them.

If the goods are really not as warranted, and notice has been given to the seller that the buyer refuses to take the

goods, the buyer cannot be held liable for the price. If he has paid any part of the sum due, he is entitled to have that money back before returning the goods, and, if necessary, may sell the goods to another party in order to get back what he has paid on them, handing over the surplus to the seller.

The measure of damages which the buyer may recover for a breach of the contract of warranty is the difference between what the goods were actually worth at the time they were delivered, and what they would have been worth if they had been as warranted.

Note:

1. In any case where the buyer intends to assert his rights, he should act promptly. Delay may be fatal. A buyer should never accept goods without examining them. Where there was a warranty of durability, he should notify the seller of his dissatisfaction, or refusal to accept the goods, just as soon as he discovers that they are not up to the warranty. It is a prudent thing in such a case to provide in the agreement of sale that the buyer may keep back part of the purchase price till he has tested the article warranted.

§ 115. Rescission of Sale

A rescission results from failure to perform a contract of sale. Both parties may now agree or one party may call it off and the other may acquiesce. If the other does not acquiesce, the rights of the parties must be determined by suit as set forth in the earlier part of this chapter.

In case of rescission: (1) The buyer and the seller may agree to cancel the contract. (2) When the seller has the goods in his possession or has stopped them on the way to the buyer, he may call off the sale if he has reserved that

right in the contract and the buyer does not carry out his agreement: or if the buyer fails to pay for the goods within a reasonable length of time. (3) The buyer may call off the contract if the goods are not as warranted.

When the sale is called off by agreement, the buyer must return the goods to the seller, and the seller must return the price to the buyer. But the buyer may keep the goods until the seller pays him back what he has paid, and the seller may keep the price until the buyer returns the goods. Either party may take the initiative. The one who most desires to cancel the sale will probably move first.

When goods are not up to the warranty the buyer must return the goods in the same condition in which they were when he received them. He may either actually return them or notify the seller that he refuses to accept them and will hold them subject to his order.

Note:

1. Either party who wants to call off the sale should do so just as soon as he finds out that he has good reason to cancel it. The court will not look with favor on any delay, as it is not fair to the other party. The buyer may sell the goods if necessary and get out of the money realized what he has paid on them. If he has paid the entire price and the goods do not realize that amount when sold, he may sue the seller for what he has lost on the transaction.

REVIEW QUESTIONS

1. What recourse has a seller who has the goods still in his possession: (a) If a sale was to be for cash; (b) if it was on credit; (c) if the goods are perishable?
2. How can goods be shipped so that title remains in the seller?
3. What is meant by the right of "stoppage in transitu"? If this right is exercised on a false rumor of the buyer's insolvency, what is the effect?
4. A seller of goods under contract, that no payment is to be made till all goods are shipped, ships some, and then finds that the buyer has failed. What can the seller do?
5. If a seller wrongfully refuses to deliver goods, what remedy has the buyer? When can the buyer enforce specific performance of his contract?
6. A salesman sells a bill of goods. The employer refuses to accept the order. Has the buyer any recourse?
7. When goods are ordered and on arrival they fail to come up to a warranty that has been made, what two alternatives has the buyer?
8. How can a sale be called off?
9. Jackson bought 70 cords of wood of Smith. The wood was piled and measured on Smith's property, and Jackson was to come to get it. Nothing more was said. Before Jackson paid for or took the wood away, he went into bankruptcy. His receiver claimed the wood, which the seller refused to give up. Who was right?
10. Farley sold a carload of furniture to a retail firm. While the goods were en route over the railroad, he learned that the firm was insolvent, and accordingly ordered the railroad to return the lot to him, offering freight and other charges. The railroad, however, claimed that it had attached the goods to satisfy a claim of its own against the insolvent firm. Could such attachment take precedence of the seller's lien?

CHAPTER XX

SALES AT AUCTION

§ 116. Regulations for Sales at Auction

A sale at auction is held in accordance with terms printed in the auction bills. The sale is made when the auctioneer lets his hammer fall. He need not accept any bid unless required to do so by the terms of the printed auction advertisement. Generally such an advertisement will specify that the property is to be sold to the highest bidder. An auctioneer may refuse to recognize bids that are not substantially higher than the last bid, the amount depending on the value of the article offered for sale.

If the seller had printed in the auction bill a provision that he reserved the right to take part in the bidding himself, he might bid at the sale or have his friends do so for him. Otherwise if the seller himself bids, or has bids made for him, the person to whom the goods are finally knocked down may refuse to take them if he discovers the situation.

§ 117. Compliance with Conditions

The sale may be made on some condition. The buyer must then comply with the condition before he can receive the goods. Sometimes bidders are required to make a deposit before being allowed to bid; sometimes they are required to make a deposit after the bid is accepted. If the bidder does not comply with the terms of the sale he forfeits this deposit, unless it appears that the seller could not give him good title to the property, in which case he may recover his deposit and refuse to take the goods.

A purchaser at an auction sale must always pay cash before he is entitled to the property unless the printed terms provide otherwise.

The seller may sue the purchaser for damages if the purchaser fails to take property which was knocked down to him. The seller may also sell the goods to someone else for what he can get for them. This amount will be deducted from his damages.

§ 118. Duties of Auctioneer

The auctioneer acts as an agent for the seller in selling the property; for the buyer in signing a memorandum of the sale. The seller will be bound to carry out the sale which the auctioneer makes, and the buyer to take the goods according to the memorandum of sale. An auctioneer is not allowed to bid for himself at a sale, but he may make bids for someone else. If he does not state for whom he is selling the property, he is personally responsible to the purchaser for seeing that the terms of the sale are carried out.

An auctioneer who sells property that does not belong to the seller is personally responsible to the owner of the property, even though he honestly thought it was part of the goods to be sold. Because of all this responsibility, the law usually requires an auctioneer to have a license. In New York a man must take out a license to act as auctioneer in order to sell even his own property.

The auctioneer has a lien on the property for his commission, and may require the commission to be paid him before giving up the property to the purchaser.

Note:

1. In planning for an auction sale, all the terms should be decided upon and printed in the handbills advertising it. If the owner of the property wants

to reserve the right to bid or to have bids made for him, it must be definitely stated.

REVIEW QUESTIONS

1. Has the owner of goods sold at auction the legal right to bid on them?
2. What should be announced in the auction bills?
3. Whose agent is the auctioneer?
4. In your state does the auctioneer have to be licensed? May a man sell his own goods at auction without a license?
5. What lien has an auctioneer?

PART IV
AGENCY

CHAPTER XXI

PRINCIPLES OF AGENCY

§ 119. Introductory

In the complex commercial life of today much of the world's business is of necessity transacted by proxy. The amount of business that one man can do is limited. Hence, to conduct the great activities of the world, those with executive ability empower others to act for them. At the present time the larger proportion of business men are not doing business for themselves, but are acting as agents for others. On this account the subject of agency is of primary importance. Many men are principals, yet more are agents; and all have to do with agents and should know what agents' powers are and just how far they represent their principals. The matter of agency enters into all departments of business and will come up again and again in the treatment of other subjects in this work. The subject of agency is of vital importance in insurance, partnership, and corporation law.

§ 120. Definitions

An agent is one who represents, or is authorized to represent, another person in a business transaction or transactions with third parties.

The person represented is known as the "principal."

The person appointed may be known as "agent," "factor," "broker," "attorney," "proxy," "delegate," or "representative."

The relation between the principal and the agent is termed "agency."

§ 121. The Principal

Anyone capable of transacting his own business may appoint an agent to act for him in the same matters. A standard text-book expresses it thus:

It may be stated as the general rule, by the common law every person who is competent to act in his own right, and in his own behalf, may appoint an agent.¹

In the California Code it is expressed as follows:

Any person having capacity to contract, may appoint an agent.

The legal doctrine of agency is based on the principle that whatever a person may do for himself, he may do by another person. The person who appoints an agent must be, therefore, capable of transacting his own business; that is, when he appoints an agent, he must be sane, sober, and capable of acting for himself, and also, he must be of full age—hence a minor cannot appoint an agent.

The following are legally qualified to be principals:

1. Corporations may appoint agents to accomplish their corporate purposes—in fact, a corporation can act only by its agents.
2. Partnerships may appoint agents, and apart from this each partner is held to be an agent for the firm.
3. Married women may appoint agents.
4. Unincorporated clubs and societies may appoint agents.

Notes:

1. The principal must be competent to act, and in his sane mind.

¹ Mechem on Agency, 129; Cyc. 31, p. 1175.

2. Infants are not competent to act for themselves, and hence cannot appoint agents.
3. Partnerships, clubs, and societies may be principals.
4. Corporations can operate only through agents.

§ 122. The Agent

Any person who is qualified to perform a particular act may do it as the agent of another.

Anyone who has capacity to act for himself is ordinarily capable of acting as agent for another . . . it is generally thought he may be capable of acting as agent for another, although he is not capable of acting for himself.³

The point to be noted in this statement is that a person may be legally incompetent to act for himself, but yet may lawfully act as agent for someone else. For instance, a minor, i.e., anyone under age, cannot contract for himself, but he may act as agent for an older person and what he does will bind the older person.³

A child may be the agent of his parent. But it must be because the child has been appointed an agent, not simply because he is the child of, or is living in the house with, the parents. In such cases, to be an agent, the child must have been directly authorized by the parent to act along certain lines, or else it must be shown that the child had been in the habit of so acting with the approval of his father or mother.

In a New Hampshire case the judge said:

A son has no authority, as such, to lend his father's property, and there is no presumption that such authority has been given the son.⁴

³ 31 Cyc. 1212; *Lyon & Co. v. Kent*, 45 Ala. 56.
⁴ *Sheldon v. Newton*, 3 Ohio State 494.
⁵ *Johnson v. Stone*, 40 N. H. 197.

Notes:

1. A minor who cannot contract for himself may contract as an agent for someone else.
2. Anyone can be an agent to do anything he is sufficiently intelligent to do.
3. A parent is not bound by the contract of a minor child unless he has expressly or impliedly made the child his agent.

§ 123. General Agents

A general agent is one authorized to assume entire charge of his principal's business, or all of one phase of the business, or all of his principal's business at some particular place.

Unless notified to the contrary, people dealing with an agent have the right to presume that his agency is a general one, and that he is authorized to do anything usually done in such a business. A general agent has unrestricted powers to deal along the line he is engaged in.

The manager of a business is a general agent with power to use his individual judgment and to act largely upon his own initiative. His employer controls and limits his general policy, but he does many specific acts at his own discretion, and delegates authority in minor details to subagents who answer to him for what they do.

For instance, the manager of a grocery store is a general agent for that purpose and has authority to purchase all kinds of goods that are sold in the store, and to contract for necessary repairs and improvements in the store. He has no authority to buy dry-goods, hardware, or other things outside his line of business. He has no authority to sell the whole store, or to buy real estate, or to build a new store. If such an agent wanted to contract for an addition to the existing store, the contractor would do well to find out whether or

not the agent had authority to do this, because this would seem not to be included in his general authority.

An agent may possess direct authority to bind his principal in a particular transaction; that is to say, the principal may expressly empower the agent to bind him; and this direct authority will carry with it, by implication of law, such powers as are suitable and reasonably necessary to accomplish the intended purpose.⁵

A superintendent of a factory is a general agent for the purpose of running the factory, and is presumed to have power and authority to do anything necessary to keep it in operation, and in case of emergency to preserve the business and the building and to protect the employees.

Notes:

1. A general agent has wide powers in his particular line of business.
2. He has no authority to bind his principal outside of his general line of business.
3. It is expedient to know, when you are dealing with an agent, whether he is a general agent or a special agent.
4. A third person, having ascertained the general character and the scope of an agency, may rely on the agent's having such powers as naturally and properly belong to his position.
5. In doubtful cases, it is safest for those dealing with a general agent to ascertain the extent of his authority.

§ 124. Special Agents

A special agent is one authorized to act in a specific transaction or in a limited line of business. The authority of a

⁵ Hackett v. Frank, 105 Mo. App. 384.

special agent is not so broad as the authority of a general agent.

A special agent is authorized to do some special thing. He may make, for instance, but the one contract or the one sale for which he has been appointed. Should he do some other special thing, which he honestly considers more to the interest of his principal, he would depart from his instructions and he alone would be liable; the party represented would not be bound. For example, an agent authorized to sell a particular painting would have authority to sell *that* painting and to bind his principal in what he did in connection with the one transaction, but he would have no authority to do anything else.

Similarly, a special agent might be authorized to buy wheat for his principal; in that case he would have no right to buy lumber, coal, or another grain, but he could bind his principal in any transaction for the purchase of wheat. If the agent has an established office or place of business where he has been doing business for some time with a sign or signs indicating his agency and line of business, a third person would be safe in doing business with him in the particular line.

In dealing with a special agent engaged for a particular transaction, a third party should ask to see the agent's authorization, which is usually in writing.

In a New York case, a father authorized his son, to accept a draft for \$2,000, drawn upon the father at not less than thirty days. The son accepted a draft for \$482, payable ninety days after date, in the name of his father. The court held that he was a "special agent," and had no right to go outside of his authority.⁶

A written request to a real estate broker as special agent, to find a purchaser for real estate, does not confer upon him

⁶ *Nixon v. Palmer*, 8 N. Y. 398.

any authority to sign a binding contract of sale for his principal. To do this, he must also have authority from his principal to sell.

Notes:

1. A special agent has limited authority.
2. This authority may be indicated by:
 - (a) Written authorization.
 - (b) An established office with signs and advertisements.
 - (c) A continued course of dealing.
3. No one can become the agent of another except by the will, expressed or implied, of the principal.
4. An agent cannot create in himself a particular authority merely by the performance of the act.

§ 125. Del Credere Agents

A *del credere* agent is one who guarantees to his principal that any goods sold by the agent will be paid for.

An agent employed to sell goods sometimes guarantees his principal against loss from any of the customers to whom he sells; in such case, the agent is termed a *del credere* agent. It is not a common arrangement, but nevertheless it is used occasionally in mercantile circles.

A factor with a *del credere* commission or agency is one who in consideration of a higher compensation expressly agrees to pay his principal the price of the goods he sells himself, if the purchaser does not.⁷

A contract of a commission merchant whereby he, for a commission of 5 per cent, undertakes to sell goods and guarantees his sales, need not be in writing.⁸

⁷ 20 Cyc. 186.

⁸ *Sherwood v. Stone*, 14 N. Y. 267.

REVIEW QUESTIONS

1. Who may appoint an agent?
2. Who may act as agent though not as principal?
3. Distinguish between general and special agents.
4. Can a real estate agent as such sign a contract binding his principal to sell?
5. What is a *del credere* agent?
6. If a boy came into a store and wanted to buy an Ingersoll watch and have it charged to his father, what would you advise?

CHAPTER XXII

THE CONTRACT OF AGENCY¹

§ 126. Appointment

The appointment of an agent may be oral, written, or by usage. An agent can be legally appointed for most purposes by an oral or spoken contract. The objection to an oral contract is the difficulty of proving it, and the strong probability that there will be some misunderstanding as to the terms of the contract between the parties. For all ordinary purposes, an oral contract of agency is just as binding as a written contract, provided its terms can be proved.

Usually an agent is appointed in *writing*; either a formal contract is drawn up and signed by both parties, or a letter or a telegram is sent and the other party replies to it, in which case the letter or the telegram and the reply thereto would constitute the written contract.

When an agent is appointed to vote at a corporate meeting, his written appointment is called a "proxy," and is usually signed by the principal and by a witness. Some corporations require acknowledgment of the proxy before a notary public; but this is not usually necessary. (See Chapter CII, Forms 31-33.)

When an agent is appointed to sell land, or to perform any important act, or to conduct any important negotiations, he is given formal power of attorney under seal (see Form 28). A power of attorney is a particular kind of written contract of agency. Where land is to be deeded or a mortgage executed, the agent is called an attorney in fact and it is

¹ For forms of agency contracts, see Chapter CII, Forms 26-33.

absolutely essential to have the formal power of attorney executed just as carefully as a deed, and acknowledged before a notary so that it can be filed in the registrar's office with the deed or the mortgage. (See § 130.)

• In many cases of agency, the agent is appointed to an office where he exercises certain powers *without any formal specification* of what he can do and what he cannot do. In such instances, the agent will be held to have all the powers usually attached to such an office. For instance, a ticket-seller for a railroad is an agent of the company and has certain well-known powers; beyond these he cannot go.

An agent appointed to conduct a given business for his principal has authority to do all things incidental or essential to the performance of his duties as agent. If the duties of the agent involve the management of a mercantile business, and it is necessary to employ salesmen, the principal will be bound for the salaries whether he has given express authority to the agent to employ assistants or not.²

Notes:

1. An oral contract is hard to prove, and is liable to be misunderstood.
2. An agent should be appointed by a written contract signed by both parties.
3. An agent to sell or to mortgage land must be appointed by a sealed power of attorney executed and filed like a deed.
4. An agent conducting business for his principal has the usual powers of anyone doing such a business.

§ 127. Express Appointment

The express appointment of an agent requires a specific designation of the agent by the principal. Such an appoint-

² *Baldwin v. Garrett*, 111 Ga. 876.

ment consists of a definite contract for the agent's services. Most agents are appointed in this way.

The *express authority* of an agent is that authority which the principal directly grants to him. This includes of necessity (whether the agency is general or special) all such powers as are necessary and proper as a means of effecting the purpose for which the agency was created.³

The apparent authority of an agent is that which the principal knowingly permits the agent to exercise, or which the agent exercises without objection from the principal.

§ 128. Implied Appointment

The appointment of an agent is implied when it is just to infer it from the circumstances. If A stands by and sees B sell goods which belong to A and makes no protest, but acquiesces, A will be held to have appointed B his agent and will be bound by B's transactions. This is also called "agency by estoppel," because A will be estopped from denying the fact of B's agency after acquiescing in B's acts as agent and permitting a third person to so regard him.

When in the usual course of the business of a corporation an officer has been allowed, in his official capacity, to manage its affairs or to make certain contracts, his authority to represent the corporation will be inferred from the manner in which he has been permitted by the company to conduct its business.⁴

A wife, as the domestic manager of the house, may buy all things that are naturally and ordinarily necessary for the management of a household. She may contract for household supplies, domestic service, medical attendance, articles of clothing for the use of herself and children, suitable to the style in which the husband lives. It is implied that she is authorized to do this, and the husband is held responsible for

³ Dispatch Ptg. Co. v. Nat'l Bank, 109 Minn. 440.

⁴ Martin v. Webb, 110 U. S. 7.

the cost. She is not held to be authorized beyond this, unless expressly made the agent of the husband for some particular purpose, in the same manner in which he would appoint a stranger.

Notes:

1. An agent's authority should be expressed by a written contract.
2. But an agent's authority may be implied from the conduct of his principal.
3. An agent placed in a position requiring authority has implied authority to do all things that are necessary.

§ 129. Ratification

Where one acts as the agent of another without authorization, his acts as agent may be ratified by the acquiescence of the principal or by the principal's taking the benefit of the agent's performance. It happens not infrequently that an agent, appointed for a definite set of duties, sees opportunity to do something for which he has no authority, but which will benefit his principal. Sometimes a person volunteers to act as agent for a principal whom he has not had opportunity to consult. After an unauthorized act of this kind has been done, the principal may (when he learns of it):

1. Refuse to be bound by it.
2. *Expressly ratify* the act.
3. Impliedly ratify it, by taking the benefit of the action.

If the principal ratifies the unauthorized action, he must ratify it as a whole. He may not ratify part of the agent's act and refuse to recognize the other part.

Ratification, to be effectual, must be made with full knowledge of everything which has any material bearing on the transaction.

Notes:

1. Ratification has the same effect as an original authorization.
2. Ratification may be express, or by acquiescence.
3. Taking the benefit of an unauthorized act (with knowledge of the circumstances) is a ratification of the act.

§ 130. Sealed Contracts

An agent, in order to execute a deed or sealed instrument, must be appointed by an instrument of like formality.

For most purposes an agent may be appointed by a simple written agreement or by word of mouth; and sometimes his authority may be implied from circumstances. When, however, land is to be conveyed or mortgaged, or some important instrument like a deed or a mortgage which is to be recorded in some office of public registry is to be executed, it must be done by the principal himself or by an agent appointed by power of attorney executed with all the formalities of a deed or instrument for record, which must be filed in the same office of public registry as the deed itself. An agent appointed by a power of attorney is called an "attorney in fact."

The most important feature of a deed is the fact that it is *executed under seal*. It is usually witnessed and is then acknowledged before a notary public. The power of attorney requires the formal execution and the same acknowledgment that a deed would require. The doctrine may be summarized thus: An agent to contract under seal must be appointed under seal.

Authority under seal is necessary to enable an agent to bind his principal by a deed or other instrument under seal. It is a technical, but a thoroughly settled rule of the common law, that an agent cannot bind a principal by a deed of con-

veyance, bond or other instrument under seal, unless his authority to do so is also under seal.⁵

There is no doubt about the general rule that a power to execute an instrument under seal must be conferred by an instrument under seal executed with equal solemnity.⁶

Note:

1. A deed must be executed by the owner of the land or by his agent or attorney appointed under seal.

§ 131. Appointment of Subagents

Unless expressly or impliedly authorized, an agent is not empowered to appoint a subagent.

When an agent is appointed, he is appointed because the principal places special trust and confidence in him. It would not be right for an agent to have power to delegate his authority to someone else, whom the principal might not care to have represent him. This is a maxim of the law—that delegated authority cannot be passed on to someone else unless the agent has been expressly authorized to do so, or unless it is customary in the particular line of business.

A distinction is to be taken in this matter between acts requiring discretion and acts that simply involve some mechanical performance. An agent authorized to perform some important work could employ others to help him in the mechanical details. If it were customary, he could employ an assistant superintendent and supervisors, but he could not delegate the active supervision to someone else.

Notes:

1. An agent cannot appoint a subagent.
2. If he attempts to do so, (1) his appointee will have no power, and (2) the agent will be personally liable for the subagent's wages.

⁵ Clark & Skyles on Agency.

⁶ Long v. Hartwell, 34 N. J. L. 122.

§ 132. Servants and Employees

An employee or servant may also be an agent if authorized to do business with third parties.

The distinction between an employee or servant and an agent is that the employee or servant is employed to do certain things and has no relation with third parties, while an agent is employed to represent the principal in dealings with third parties. It happens in many cases that an employee is also an agent, but his functions as an agent are distinct from his functions as an employee. A servant employed in domestic activities becomes an agent when he or she is authorized to buy supplies, or to do anything else that involves dealing with third parties. (See § 136.)

If a delivery man has been in the habit of making collections, it would be safe to pay him. If a package has been sent C. O. D. the bearer is thereby authorized to receive the amount.

If an employer acquiesces in his employees' acting as his agents, he will be estopped from denying their agency. (See § 128.)

Notes:

1. It is not safe to deal with a servant or an employee unless he or she is authorized to do business with third parties.
2. It is not safe to pay money to truck drivers, delivery men, and errand boys, unless it is known that they are authorized to make collections.

§ 133. Void Contracts of Agency

Contracts of agency for an unlawful purpose, as is the case with other contracts (see § 39), are illegal and cannot be enforced.

For example, a contract to conduct a gambling establishment would be absolutely void. The principal could not com-

pel the agent to carry out the contract, and the agent could not collect any compensation for the unlawful service.

A contract to procure an agent to commit a positive crime, to bribe legislators, to forge a will, or to commit a burglary, is void absolutely and entirely.

Any contract opposed to public policy is void.

Certain things are said to be against public policy. The following are examples: to employ a lobbyist to influence legislation; to contract with a lawyer to organize a trust in restraint of trade; to employ a broker to negotiate a marriage; or to bribe a purchasing agent to buy from you.

In any contract to do an unlawful act, both agent and principal are liable to damages and to criminal prosecution. If an agent or an employee were engaged to smuggle silks, both the subordinate and the principal are liable to prosecution and whatever penalties are imposed. In legitimate business the agent acting within his authority makes his principal liable but does not make himself responsible. In any illegal business, the responsibility attaches to principal and agent alike. (See § 146.)

Notes:

1. Any contract for an illegal or immoral purpose is void.
2. An agent employed to act illegally cannot collect any compensation.
3. In a contract for an illegal or immoral act, both principal and agent will be liable to damages and to criminal prosecution.

REVIEW QUESTIONS

1. How may an agent be appointed?
2. What is necessary to appoint an agent to convey land?
3. What may an agent do in the absence of formal specification?

4. To what extent is a wife the implied agent of her husband?
5. How may a contract be ratified?
6. Define "power of attorney" and "attorney in fact."
7. Can an agent appoint a subagent? Explain answer..
8. Distinguish between a servant and an agent.
9. What contracts of agency are void?
10. Can an agent who collects a gambling debt recover an agreed commission?
11. What is agency by estoppel?
12. A's wife was ill and the family physician said that he would like to consult with a specialist. A said that he was willing. The family physician called in the specialist, whose diagnosis afterwards proved to be erroneous. Later the specialist brought suit for his services, to which A made the defense that he did not employ the specialist, and that the diagnosis was erroneous. Can the specialist recover? Give reason for answer.
13. What general facts are necessary to validate an unauthorized assignment by an agent?
14. Does the relation of agency always rest on consent?
15. In your state is there any provision of the law with which one must comply in order to conduct a general mercantile or manufacturing business in a fixed location as agent for another?

CHAPTER XXIII

THE PRINCIPAL

§ 134. Principal's Duty to Agent

The principal's duty to his agent is to pay him his compensation and proper expenses. The relation of the principal to the agent is one of contract. The agent agrees to render services and the principal promises to pay him a salary, a commission, or a fixed sum. If no amount of compensation has been fixed, the agent will be entitled to whatever his services are reasonably worth. Unless provided otherwise, the principal is bound to reimburse him for whatever expenses he has properly incurred. The contract should be a written one to avoid misunderstandings and to supply evidence of what the agreement really was.

The usual rules which govern employment prevail in this relation. If the principal terminates the agency before the end of the period of employment, he must compensate the agent for the unexpired term less any amount the agent can secure from some other employment. If the agent were to be paid a commission or a gross sum and the principal were to terminate the agency unreasonably, the principal would be liable to pay damages for the breach of his contract. If the agent had completed his undertaking, even though the principal did not take advantage of what the agent had done, the agent nevertheless would be entitled to full payment for his services.

In a Missouri case, one Gelatt, a real estate agent, was employed by the owner of a business block to find a purchaser for the property. He found a buyer, but the owner advanced

the price and broke up the deal. The court decided that Gelatt was entitled to his full compensation.¹

If the principal makes it impossible for the agent to complete the undertaking, he must compensate the agent.

Note:

1. The principal's duty to his agent is simply to deal fairly. An express contract in writing will prevent misunderstanding.

§ 135. Principal's Duty to Third Party

If the principal leads the third party to think that the agent has authority beyond his express authorization, the principal will be bound by whatever the agent does in the exercise of his apparent authority. In many such cases, the principal becomes bound, not by any positive thing which he has said or done, but because of his acquiescence in what the agent was doing, or his failure to protest at the proper time. In other cases the principal has allowed the agent to do certain things beyond the latter's authority; and this has continued until a course of dealing has become established. In all such cases, third persons are justified in assuming that the agent's apparent authority is real, and the principal will be bound.

The principal is liable for all acts done by the agent within the *apparent*, as well as *actual*, authority given. (See § 128.) Third parties dealing with an agent do not know his secret instructions, and whatever authority the agent appears to have can be used by him to bind his principal. The third party must, however, (in good faith) believe that the agent has the authority.² The agent's own representations as to the extent of his authority, if false, will not bind his principal.

An agent to sell goods who has possession and is in position to deliver is authorized to receive payment; but if he is not in

¹ Gelatt v. Ridge, 177 Mo. 553.

² Johnson v. Hurley, 115 Mo. 513.

possession of the goods he is not authorized to receive payment. Usage and trade customs count heavily in deciding what constitutes the apparent authority of an agent.

Notes:

1. When an agent is appointed, he is given as much authority as his position seems to warrant.
2. Secret instructions or limitations on the agent's authority do not bind third parties unless such instructions are known to these parties.

§ 136. Principal's Liability

A principal is liable for all fraudulent, negligent, or wrongful acts of his agent in the scope of his employment. If this were not so, it would be possible for a man to perpetrate all manner of fraud and wrong, and to escape punishment by employing some agent of no repute to do the dirty work. A principal is liable for carelessness, deceptions, false pretenses, or wrongful acts of any kind committed by the agent in carrying out the purposes of his principal.

The principal is liable for any damages to third persons arising from the mistakes or the negligence of an agent or an employee while acting in his service.

In a case in Rhode Island, a salesman suspected a woman customer of stealing a package of spoons. He detained her, sent for a policeman, had her taken to a police station and searched. She brought suit against the firm that employed the salesman for the wrongful arrest and search, and was awarded damages. The court said:

If in the performance of his duty he, the salesman, mistook the occasion for it or exceeded his powers or employed an improper degree of compulsion, the mistake and the excess must be answered for by the master.³

³ *Staples v. Schmidt*, 18 R. I. 224.

If an automobile salesman takes out a machine belonging to his employer to show to a prospective customer, and carelessly runs over a foot traveler, the employer will be responsible. If the salesman takes the machine out after hours for his own pleasure and does the same thing, the employer will not be responsible, because the accident did not occur within the scope of the salesman's duties.

Notes:

1. A principal is responsible for whatever is done by his agent within the scope of his employment.
2. A principal is not responsible for the acts of his agent done outside the scope of his employment.

§ 137. An Undisclosed Principal

An undisclosed principal may take the benefit of any contract made by his agent. As has been stated, an agent may conceal the fact that he is acting for a principal. In such a case, the agent renders himself personally liable, but a principal has the right to take whatever benefit may come from any advantageous contract made by his agent. The undisclosed principal is liable if the third party discovers his existence. With this liability the principal has the right to take the benefit of the contract.

Byington v. Simpson was a case in which a building contract was signed "J. B. Simpson, Agt." The third party knew that Simpson was in fact contracting for his wife. The wife was held liable though her name was not mentioned.⁴

The third party, upon discovery of an undisclosed principal, may hold responsible either the agent or the undisclosed principal. He must elect to hold one or the other; he cannot hold both. To this rule there are the following exceptions:

1. If the contract made by the agent is in the form of a negotiable instrument or a sealed contract, the undisclosed

⁴ *Byington v. Simpson*, 134 Mass. 169.

principal has no rights or liabilities. He cannot sue or be sued, as such instruments are considered as having been taken solely on the face of the names appearing thereon.

2. If the principal, before his identity was disclosed, in good faith paid the money due on the contract to the agent, he cannot be held liable. This is perfectly fair to the third party because he gave credit to the agent and expected to get payment from him and had no knowledge that there was somebody behind the agent. The third party may collect from the agent if he can, but it would be unfair to let him collect from the unnamed principal who in that case would have to pay a second time.

3. If the third party after learning that there is a certain principal, unequivocally chooses to hold the agent, he cannot alter his decision and proceed against the principal.

4. If the contract states clearly that it is made only by the parties signing and that no other parties are to be introduced into the contract, the undisclosed principal rule would not apply.

Notes:

1. The agent who does not disclose his principal takes the entire responsibility on himself.
2. The undisclosed principal is liable when discovered.

REVIEW QUESTIONS

1. What are the duties of a principal to his agent?
2. What rules usually prevail in the relation between agent and principal?
3. For what acts of the agent is the principal responsible?
4. What does the "scope of employment" mean?
5. Do false representations of an agent in the "scope of his employment" bind the principal?
6. What is an undisclosed principal? What risk does his agent take?

- 7. What may a third party do on discovery of an undisclosed principal?**
- 8. May the principal benefit by any transaction in which the agent conceals the fact that there is a principal?**
- 9. What is the rule as to an undisclosed principal in the case of a sealed instrument or negotiable paper?**

CHAPTER XXIV

THE AGENT

§ 138. Agent's Duty to Principal

An agent is, in the line of his duties, subordinate to his principal. Therefore, it is an essential feature of his employment that he should obey orders, act with good faith, and use such prudence, skill, and diligence in his duties as are requisite for their proper discharge. He must, if necessary, keep proper accounts and render statements to his principal. He cannot delegate any duty demanding discretion to others without special authority. If he does not do all this, if he fails in his duty, he may be discharged, his compensation may be denied, and he may be responsible in damages.

Any profits made in the course of an agent's employment belong entirely to his principal. An agent may not use his agency for his own advantage.

One Cummings, an agent for the sale of stock for the Diamond Match Company, sold stock of the company amounting at par to \$170,000 for \$200,000, and kept the profit of \$30,000 for himself. Later this was discovered by the company, which brought suit and recovered the whole amount.¹

In making a contract with an agent or confidential employee, it is safest to contract that he shall not at any time, either while he is employed or thereafter, reveal or use for the benefit of others any special information, secret processes, lists of customers, or other private matters that may be learned in the course of his duty. The courts will protect such an agreement.

¹ *Graham v. Cummings*, 208 Pa. St. 516.

In a Michigan case, a party employed in a manufactory of fly paper, under contract not to use methods elsewhere, after severing his connection with the factory, made plans to give others the benefit of his information. The court granted an injunction to prevent him from revealing the processes.²

Where a salesman or solicitor is employed to work up trade, he necessarily becomes familiar with the list of customers. In such a case, a contract with an agent that he shall not, for a period of years, engage with any other house in the same line doing business in the same territory, will be sustained by the courts.

What is here said as to the duty of the agent refers to a general agency, where the agent gives his entire services to one principal. In cases of special agency, what is said of the agent's duty applies only so far as is necessary to effect the object of the agency. A bank may be an agent to collect a draft, but is not called upon to exercise general obedience, loyalty, etc.

Notes:

1. A general agent must be obedient, loyal, careful, skilful, honest, and of good habits.
2. A special agent is required to exercise only such qualities as are requisite to effect the purpose of his agency.

§ 139. Agent's Obedience

Disobedience is good cause for discharge or refusal to compensate an agent, and renders him liable for any resulting damage. It is an agent's duty to obey orders; and by so doing he relieves himself of any responsibility in case of misadventure.

If, however, circumstances should arise which make it

² *Thurm Company v. Tloczynski*, 114 Mich. 149.

necessary to act contrary to the instructions he has received, it is his duty to do this, provided, of course, that it is impossible to consult his principal before acting. Emergencies may occur where it is the duty of the agent to do the best thing possible, even though it involves his disregarding orders. Where no emergency exists, however, the agent violates his directions at his own risk. It is the principal's right to decide how he wishes his matters attended to; and if the agent obeys and loss ensues, it is the loss of the principal. If a shipping agent or railroad varies directions that goods are to go over some particular line, the agent or the railroad incurs the liability of an insurer.

An agent who has been instructed to sell for cash has no authority to allow credit. If he gives credit and loss ensues, he is responsible. If he is authorized to buy or to sell at a certain price, he may not go beyond this. This is not to be understood as prohibiting trifling departures and immaterial variations from exact instructions. The law does not regard negligible things.

An agent who is instructed to ship goods or to remit money in a particular way must obey his instructions to the letter.

Notes:

1. An agent must obey orders if he does not want to make himself liable.
2. When an emergency exists he may act contrary to instructions.
3. A principal should, where possible, give explicit orders to his agent.

§ 140. Agent's Good Faith

Good faith is essential on the part of anyone acting in the capacity of agent. If an agent is found to be working for his own interests as opposed to those of his employer, he may be discharged summarily. If he makes false reports or deceives

his employer, or defrauds him in any way, he may be discharged; and he will have forfeited any claim to compensation. If he learns of anything in the line of his business to the principal's advantage, it is his duty to let his principal know and have the benefit of it.

A broker, in a Michigan case, sold land to a party whom the owner had previously excepted from those to whom the broker might sell. It was held that the latter was not entitled to commission.³

In a Massachusetts case, an agent made a sale of some property, and in rendering the account to his employer charged him \$50 as paid to an attorney for examining the title, whereas he really paid only \$25. The court held that he lost his right to commission.⁴

The Agent Must Not Act for Both Parties. An agent may not represent both parties to a transaction. He may not earn a commission from both buyer and seller. This is a rule that holds good everywhere. But it is said that a double agency may be valid where both parties know of the double agency and agree to it; it is then understood that the agency requires no independent discretion.

The Agent Must Not Act for Himself. If the agent is employed by a principal to manage his business, what he does is done for the principal. It is not right for the agent to be interested adversely; and all the profits that are made in connection with the principal's business belong to the principal, unless he has previously agreed to give the agent a share of the profits as part or all of his compensation.

If the agent in the course of acting for his principal obtains any particular advantage to himself, and the principal discovers it, the latter can hold the agent accountable for the profits or the property so obtained.

³ Ranney v. Henry, 160 Mich. 597.

⁴ Little v. Phipps et al., 208 Mass. 331.

An Agent Must Not Compete With His Principal. An agent must not be interested adversely to his principal. Neither may he represent and sell goods for a competitor of his principal. An employer has a right to his agent's absolute loyalty. If an agent uses his knowledge of his principal's affairs to secure an advantage for himself, the courts will compel him to make restitution. The law moves on a high plane in matters of this kind.

The Agent Must Be of Good Habits. Any habits which interfere with the proper discharge of the agent's duty are sufficient reason for his discharge. Drunkenness in the daytime or while attending to business is undoubtedly sufficient reason for dismissal. As in the case of other employees, the circumstances must be considered.

Generally speaking, an agent may be discharged for drunkenness, gambling, or licentiousness. Possibly, the courts would not in all cases justify too close an inquisition into the private habits of employees. A bank, however, employs detectives; and if an employee indulges in loose living he is discharged and has no recourse. Usually an agent who is discharged for any reason of this kind cannot afford to risk the notoriety involved in an attempt to hold his employer for damages.

Non-Payment No Excuse for Non-Performance. The fact that the agent is unpaid does not affect his responsibility. The agent's liability does not depend upon how well he is paid for what he does, or whether he is paid at all; for, if he undertakes to do anything for another, he must do it well; and he is responsible in case of bad faith, negligence, or lack of skill.

Notes:

1. The doctrine of the law on the subject of the agent's good faith is on an exceptionally high plane.
2. The agent must not act as the agent of both parties unless both know of and agree to it.

3. The agent must not act for himself in the principal's affairs.
4. The agent must not compete with his principal.
5. The agent must be of good habits.

§ 141. Agent's Care, Skill, and Diligence

If anyone undertakes the duties of an agent, he is assumed to have the necessary skill and ability to perform the said duties. In all matters connected with his agency, he is expected to act as an ordinarily prudent, careful business man would act in the conduct of his own affairs. If the agent is a lawyer, he undertakes to have professional ability to represent his client in an adequate manner. If he is a financial agent and invests his client's funds imprudently, he is responsible.

The rule is well settled that an agent is not only bound to act in good faith, but to exercise reasonable diligence, and such care and skill as are ordinarily possessed by persons of common capacity engaged in the same business.⁵

A firm engaged as insurance brokers, if it takes out policies for its clients in irresponsible companies, will, in event of loss, be required to make good the damage resulting from its neglect to use proper care.⁶

Custody of Funds. It is the duty of the agent to account for all funds and property of the principal which come into his possession. In this particular he must obey the rules that govern one person who holds the property of another.

The agent should not deposit funds belonging to his principal to his own bank account; but should open a separate account in the name of his principal, or in his own name *as agent*. If he does this, he is not responsible in the event of the bank's failure and the loss of part or all of the funds. In the same way, it is his duty to turn all money and other

⁵ Whitney v. Martine, 88 N. Y. 535.

⁶ Sheppard v. Davis, 42 A. D. (N. Y.) 462.

property in his possession over to the principal or to the principal's order.

Any money held by an agent for his principal is a trust fund.

In an Indiana case the judge said:

In case it becomes the duty of an agent or a trustee to deposit money belonging to his principal, he can escape risk by making the deposit in his principal's name; or by so distinguishing it on the books of the bank as to indicate in some way that it is the principal's money. If he deposits it in his own name, he will not, in case of loss, be permitted to throw the loss on his principal.⁷

Notes:

1. The theory of the law in these matters is better than the results in actual practice. It is in most cases impossible to obtain legal redress for the common lack of care, skill, and diligence in agents.
2. In all matters relating to the care and the custody of money belonging to others, too great care cannot be exercised.
3. The treasurers of clubs, informal organizations, and unincorporated associations, should observe the rules that have been given for agents in charge of funds.

§ 142. The Agent's Signature

The agent is acting for the principal, therefore when he signs a contract he should sign the principal's name, followed with his own in this form: "By Henry Parker, Agent." When there is a regular course of business, a rubber stamp will probably be used with a blank for the written signature of the agent, as follows: "George Wayman, By —, Agent." Such

⁷ *Waltner v. Dolan*, 108 Ind. 500.

a signature is safe and in no case can it bind the agent personally.

A corporation can act only by its agents. The rule as to the signature of contracts is the same and the name of the corporation followed by the name of the officer signing is the proper form. Letters are often signed by the officer, as "James Haywood, President," the letterhead showing the name of the corporation and that the individual signing holds the office he claims.

The better practice is to have the full corporation signature :

Edgemont Water Company,
By Harvey Gray, Treasurer.

Where notes or other negotiable papers are to be signed by the agent for a corporation or other principal, it is not safe to sign except in the approved form, the principal's name in full followed with "By —, Agent." Any other signature may not only fail to bind the corporation or other principal but may involve the officer or agent in a personal liability as maker or indorser.

§ 143. Agent's Duty to Third Party

Observance of the usual rules of fair dealing and honest treatment is the only duty owed by the agent to the third party. The agent is the representative of his principal, and is to work in the interests of his principal. If he resorts to trickery or fraud, he himself is liable for any damages caused to the third party. An agent cannot be held for a legitimate business contract within the scope of his authority. He binds his principal, not himself. But his principal cannot authorize him to do wrong; and if he does wrong both he and his principal are held.

The agent may legally do whatever the law allows his principal to do. The law is not at its best when it defines the

rights of buyer and seller. The better business houses, in their actual practice, act on a plane far higher than that which the law compels. In other words, good business prescribes a much higher standard of morality in the matter of sales than does the law.

On this account the standards of good business are given here, rather than the legal requirements. Let your dealings be characterized by fairness and liberal treatment. Deal with the third party in such a manner that you can deal with him again. All good and permanent business is to the advantage of both parties. Make every customer a lasting business friend. Treat him as you would like to have him treat you in a like case.

Note:

1. If an agent has a principal who does not believe in the above standard of good business, he had better look for another job.

§ 144. Limitation of Agent's Authority

The agent rarely has unlimited authority. In established positions, such as that of a bank cashier, a railroad conductor, or a retail salesman, the duties are settled and the authority of the incumbent is known to his principal, to those he deals with, and to himself. Usually an agent in such a position keeps to his routine, and his powers are entirely familiar to all concerned.

As between his principal and himself, the agent's authority is limited: (1) by the limitations usual to the employment, and (2) by the limitations expressed in the agreement. If he exceeds these limitations, he may be discharged from his position, and may be held for damages if he is responsible.

In dealing with third parties, the agent, in all those cases where his apparent authority exceeds his real authority, may bind his principal. In such an event, the agent must answer to his principal for his abuse of authority.

Notes:

1. An agent has the usual authority pertaining to his position, unless restricted by special agreement.
2. An agent has always such authority as his agreement with his principal permits.
3. An agent may bind his principal wrongfully when his apparent authority exceeds his real authority.

§ 145. Agent's Fraudulent Conduct

The question of the agent's bad faith to his principal has already been discussed. If he perpetrates a fraud on a third party while transacting his principal's business, both principal and agent are liable. The agent will not be able to shift responsibility to his principal. A principal cannot authorize his agent to commit fraud.

In *Weber v. Weber*, the action was against Caroline Weber for stating positively that there was no mortgage on a piece of land which she was selling as the agent of her husband. The court said:

All persons who are active in defrauding others are liable for what they do, whether they act in one capacity or another.⁸

In a case where the president of a medical institute was made a party defendant in a proceeding against the institution for defrauding a patient, the judge said:

We are not aware of any rule of law which will excuse and absolve a person from the consequence of his own wrong doing, because he happened to be the agent of another at the time of the perpetration of the wrong.⁹

Notes:

1. An agent cannot use his agency to protect him in doing wrong.

⁸ *Weber v. Weber*, 47 Mich. 569.

⁹ *Hedin v. Minneapolis Medical Institute*, 62 Minn. 146.

2. In case of fraud or misrepresentation, the agent as well as the principal is liable to the person injured.

§ 146. Agent's Liability

The agent makes himself liable with his principal, as we have seen, when he is guilty of any fraudulent conduct.

Where the business is illegal, the agent is liable with the principal.

He also makes himself liable when he exceeds his authority, unless the third party knows the nature of the agent's action.

In most cases where an agent deals with third parties, the third parties depend upon the agent to inform them correctly as to the extent of his authority. If the agent deceives them as to this, he makes himself personally liable to the third party to the same extent that he would be had he made the contract in his own name instead of that of his principal.

One Kroeger insured his premises through Pitcairn, an agent, who told Kroeger that he could keep a small amount of gasoline on the premises without making his policy void. Pitcairn had no authority to do this. The premises were burned, and Kroeger could not recover from the insurance company on account of the storage of gasoline. The court did, however, allow him to recover his damages from Pitcairn.¹⁰

If the agent has apparent authority but is limited by private instructions from his principal, he can nevertheless bind his principal by his contract within the scope of his apparent authority. In such a case, he is liable to his principal for any unwarranted action.

It happens sometimes that an agent deals with third parties and assumes to be the principal; i.e., he does not represent himself to be an agent, or disclose the fact that he is acting for someone else. In such a case he will be held personally, as though he were the principal. This is plainly just and right.

¹⁰ Kroeger v. Pitcairn, 101 Pa. St. 311.

Where an agent represents a principal who is non-existent or irresponsible, he binds himself. On occasion agents have represented themselves as having a principal who did not exist—in such cases they bind themselves. Thus, parties acting as directors in a non-existent corporation may be held.

If an agent represents any irresponsible body, such as a social club, a meeting, or any informal organization, he will in all such cases render himself liable. If the agent is authorized by a motion, all members who voted for the motion are liable, and those who are forced to pay can hold for contributions all others who joined in authorizing the expense.¹¹

The Northeastern Pigeon & Bantam Society, a voluntary association, held an exhibition of fancy stock and offered premiums. The expense exceeded the receipts. The court held that those members who paid the loss could bring suit to compel all the other members who had voted to hold the exhibition to pay their pro rata.¹²

A common case under this general head is that of a promoter who incurs liabilities for a corporation before it is incorporated. Until the corporation has come into being, it cannot appoint an agent; therefore the general rule is that the corporation cannot be bound, and that those who deal with the promoter must look to him for compensation.

The general doctrine that no one is authorized to contract for a corporation before it is formed, applies to all contracts with and by promoters. The promoter himself is liable on these pre-corporate contracts, unless otherwise expressly provided; but the corporation is not.¹³

Where an agent commits an assault in the discharge of his duty, he may be held responsible.

The agent in charge of the grounds of a fishing club in

¹¹ *Lewis v. Tilton*, 64 Iowa 220.

¹² *Ray v. Powers*, 134 Mass. 22.

¹³ Conyngton's "Corporate Organization and Management" (Edition of 1917), § 32.

Kentucky, assailed a party whom he accused of trespassing. The party assaulted brought suit for damages against the agent and the club, and got judgment against both.¹⁴

If the agent got into a quarrel independently, and not in the discharge of his duty, his principal would not be affected.

Sometimes, even when the agent acts in entire good faith, he may become personally liable for his blunders. For instance:

In a California case, Wilson, a broker, sold some mining stock for a customer. The stock turned out to have been stolen from a party named Swim, who brought suit against Wilson for the value of the stock. The court held that the principal who employed Wilson to sell the stock had no title and could give none to Wilson, who was therefore compelled to pay the value of the stock.¹⁵

Notes:

1. An agent is liable for fraudulent conduct.
2. An agent is liable for exceeding his authority.
3. An agent is liable if he does not disclose his principal.
4. An agent is liable if he represents a non-existent or irresponsible principal.
5. An agent is liable for wrongful acts within the scope of his employment.
6. An agent may be liable for blunders.

REVIEW QUESTIONS

1. What are the general duties of an agent to his principal?
2. Can C, an agent, in the course of his duties make any profit for himself?
3. When may an agent disobey orders?
4. A refuses to pay B commissions for sale of stock on the ground

¹⁴ *New Ellerslie Fishing Club v. Stewart*, 123 Ky. 8.

¹⁵ *Swim v. Wilson*, 13 Cal. 126.

that B received commissions from the parties who bought the stock. B proved that A knew at the time that B was also being paid by the buyers. Must A pay?

5. If an agent has not been paid promptly, can he collect money due his principal and pay himself?
6. May a lawyer act for both sides in a controversy? How would it be in negotiating a contract?
7. If money of the principal is deposited by an agent in his own name, can the agent's creditors take it?
8. Is an agent liable for money of his principal if he put it in his own cash drawer over night and it is stolen? If he puts it in a bank in his own name with a designation "Agent's Name, No. 2," to distinguish it from his own personal account, and the bank fails?
9. How should an agent execute negotiable paper in order that it may be binding on his principal and not upon himself?
10. What do you understand by the "apparent authority" of an agent?
11. A was a cashier of the Second National Bank. B was a depositor therein, and was on his way to the bank one day to make a deposit. When about half way to the bank he met the cashier, stopped him, told him that he was about to make the deposit, and asked him if he would take the money, there. The cashier agreed, took the money, made the proper entry in the deposit book, and handed it back to B. A, the cashier, however, did not put the money to B's credit, but kept it and converted it to his own use, and B sued the bank for the amount. Is he, or is he not, entitled to recover? Did the cashier have any apparent or real authority to receive the deposit?
12. When may the members of an unincorporated club be held for an agent's acts?
13. When is an agent personally liable to third persons?
14. What is the agent's liability on promissory notes signed?
 - (a) A, by B, Agent
 - (b) B, Agent for A
 - (c) B, Agent of A
 - (d) B, as Agent
 - (e) X Y Company, by A. President
15. Can a corporation be bound by contracts made before it was organized?

CHAPTER XXV

THE THIRD PARTY

§ 147. Third Party's Relation to Agent

Strictly speaking, the third party has no relation to the agent. The agent represents the principal, and the third party is dealing only with the principal. When the agent goes beyond his powers, then he makes himself responsible and may be held; the same is true when he represents an undisclosed principal, or a fictitious principal. The third party should know that the agent with whom he is dealing has authority to represent his principal, and how far this authority justifies the action of the agent.

A third party dealing with an agent in excess of his authority does so at his own risk. It is obvious that an agent cannot go beyond his authority. He is authorized for such general or special purposes as the principal indicates, and further than this he may not go.

Where an agent is empowered by a written instrument to do certain things, it is very plain that he has no authority to do anything more than what is specified; but, as in most cases of general agency the agent has the right to do everything incidental to his main agency business, it is sometimes not easy to tell what is in excess of his authority and what he has the right to do.

Law sold goods amounting to \$320 to Stokes. The sale was made by Sheridan, Law's salesman. The sale was on a credit till the end of the month. Next day the goods were shipped and a bill was enclosed in a letter. The letter, signed

by Law, said, "Please remit amount direct to me." The bill had on its face in red ink, "All remittances on account, or in settlement of bills, must be made direct to the principal." About a month later Stokes paid Sheridan the amount of the bill. Sheridan absconded with the money; Law brought suit and obtained judgment.¹

In this case the salesman had no authority to collect. The case was clear for the plaintiff, Law, because he had given notice on his billhead and in his letter of his limitation on the salesman's authority. Usually there would be more trouble in a case of this kind because the proof would not be so clear. The agent himself would be liable to suit by the third party; but in such a case the probability would be that the agent was judgment-proof or had left for fresh fields and pastures new.

In each case the third party should know for his own safety just what power the agent has to bind his principal, and that the principal is responsible. He cannot always rely on the representations of the agent himself as to the extent of his authority. It is the third party's duty to make due inquiry into the matter, as in case of a dispute later the burden of proof is on the third party to show that the agent had authority for the particular act.

Notes:

1. It is unsafe for a third party to deal with an agent without sufficient information as to his authority.
2. Care should be taken never to make payments to an unauthorized agent.
3. Where salesmen are not expected to collect payment, customers should be informed of the fact.
4. In dealing with an agent, it is necessary to know whom he represents and how far his authority extends.

¹ *Law v. Stokes*, 32 N. J. L. 249.

§ 148. Third Party's Relation to the Principal

The third party is really dealing with the principal, and the agent is merely the means of communication. When the contract is signed, the name of the agent is attached as agent, and the principal, not the agent, is bound. Therefore the relation between the third party and the principal is the same as between any other parties to a contract.

The third party is brought into the contract relation as a principal, and after that in most cases the agent is disregarded. The principal and the third party contract with each other, and, if the contract has not been executed, each has the right to compel the performance or to recover damages for any breach or failure in performance. In any dispute in regard to the contract, the resulting suit will be between the parties, and the agent will not figure save as a witness able to give material evidence. If there has been fraud or false representation on either side, the fact that the transaction has been negotiated through an agent does not affect the liabilities or the remedies.

Note:

1. When dealing through an agent, the third party should bear in mind that it is the principal with whom he contracts.

REVIEW QUESTIONS

1. How can a person dealing with an agent ascertain his authority? Why is it hard to tell what the agent has a right to do?
2. With whom does the third party really contract? If any suit arose, who would be the parties?
3. When does an agent make himself responsible to the third party?

CHAPTER XXVI

TERMINATION OF AGENCY

§ 149. Termination by Fulfilment

The agent's authority is terminated when he completes the purposes of his agency, or at the expiration of the period for which he was engaged. It is obvious that if an agent has been employed to purchase a farm and the farm has been purchased, the agent's authority is ended; or if a salesman has been engaged for a year to sell goods, it is plain that the agency, unless renewed, terminates at the end of the year. Generally, the rule is that the agency ends at the termination of the period for which the agent has been engaged, or the completion of the undertaking for which he has been retained.

The principal should in some way inform those who have been dealing with the agent that the agent no longer has authority to act. If the principal fails to do this, and the agent continues to act, the principal is bound.

Note:

1. An agency terminates naturally (a) when the term ends, or (b) when the undertaking is completed.

§ 150. Termination by Either Party

The contract of agency may be terminated at any time by either the principal or the agent. It is obvious that the contract between principal and agent (like any other contract) may terminate at any time by agreement of the parties. It is also true that the contract (since it is one of mutual trust and confidence) may be terminated at will by either one of the parties against the consent of the other party, except in the

case of an agent having an interest in the subject matter; in which event the principal cannot terminate the relation without the agent's consent. (See § 152.)

If the principal and the agent contracted for a certain period of time or for a certain undertaking, and the principal revoked the agent's authority without good cause, the former would be liable to suit for damages by the agent for breach of contract.

Where there is employment for a definite period of time, express or implied, and the agent is discharged without cause before the expiration of the period, the principal will be liable to the agent as in the breach of any other contract; in such cases the agent may elect to treat the contract as rescinded and bring an action to recover the value of his services and money expended.¹

The agent can renounce his employment at any time. The courts will not force a man to work for another against his will. If, however, the agent has agreed to act for a certain time, or to do some particular thing, he may be liable to pay damages if he breaks off before the expiration of the period. Also, if he tries to act for someone else in the same line of business before the expiration of the term, it is probable that the principal could obtain an injunction to prevent his working for a competitor. In a contract of agency, there is often inserted a clause providing that the agent shall not leave the employ of the principal and represent anyone else in the same line of business for a specified period of time after his contract terminates. (See § 138.)

If the subject matter of an agency is destroyed, the contract is thereby terminated. A case of this kind would occur when a building which is to be leased by an agent is burned before the lease is effected.

¹ *Glover v. Henderson*, 120 Mo. 367.

Notice of Revocation. So far as the agent is concerned, the act of revocation becomes operative only from the time he has actual notice thereof; notice to third parties without notice to the agent will not effect a revocation as to the agent. Conversely, a notice only to the agent is not effective as to third parties. The acts of the agent in dealing with third parties without notice are binding on the principal. Whatever is sufficient to put an agent or third party on inquiry will serve as a legal notice of revocation.

Notes:

1. Either party may terminate a contract of agency at any time.
2. Either party breaking a contract of agency for a specified period or undertaking without just cause is liable in damages.
3. An agent who breaks his contract may be prevented during the term of the contract from taking employment with a business competitor.

§ 151. Termination by Disability

An agent's authority is revoked by the death, insanity, or bankruptcy of his principal; in like manner the relation is destroyed by the death or disability of the agent. This is a principle of universal application. When a man dies, all contracts of agency cease at once; all powers of attorney, and every authority to anyone else to act for him are terminated. If in ignorance of his principal's death an agent did business for him, the business would be void and of no effect.

A case which often happens is that of a person of advanced years who gives personal property to an agent to deliver to someone else and then dies before the property has been turned over. In such cases the courts hold that the agency is revoked by the death of the principal, and the gift cannot take effect.

In an Illinois case, Mrs. Trubey had her lawyer take from a bank vault a metal box of jewels and securities. She made parcels of these and designated to whom each parcel was to go. Then she put them in charge of her lawyer, but set no time for delivery. He receipted for them and placed them in another vault. Within three months Mrs. Trubey died. The matter came before the courts for adjudication. It went to the Supreme Court of Illinois, which held that the lawyer was undoubtedly Mrs. Trubey's agent to deliver the property; but when she died the agency was revoked by that fact, and that, as the property had not been delivered, it belonged to her estate and the people designated had no claim to it. The court expressed regret that it was not possible under the rules of law to give effect to what Mrs. Trubey evidently intended. It would seem that her lawyer was much at fault.²

The death of the agent also terminates the relation. When the relation of principal and agent is broken up by the sickness or other disability of the agent, the condition will be the same as when any other employee finds his term of employment broken by disability. In all such cases the general rule is that the agent or the employee is entitled to recover for the time he acted, whatever the services were worth to the principal or the employer.

In a New York case it was held that when an agent is prevented by sickness or death from completing his contract, he or his executor is entitled to the value of the services actually rendered.³

Insanity of the principal has the same effect as death. If insane, a principal can no longer contract himself, and neither can he contract by an agent. The insanity of the agent terminates the relation because he has no longer the capacity to represent his principal.

² Trubey v. Pease, 240 Ill. 513.

³ Wolfe v. Howes, 20 N. Y. 197.

The bankruptcy of the principal, and in some cases of the agent, would destroy the relation. In the case of bankruptcy, the bankrupt can no longer continue his business, but it is taken over by the court or the trustees in bankruptcy; and as he cannot do business himself he cannot do it through an agent. Insolvency would not have this effect. (See Chapter LXXXI.)

If the principal parts with the subject matter, that terminates the agency.

Notes:

1. An agent can act only for a party who can act for himself.
2. An agent's authority ends when the capacity of the principal to contract ends.
3. An agent's incapacity to act ends the relation.

§ 152. An Agent with an Interest

An agency coupled with an interest cannot be revoked by the principal nor will his death or insanity revoke it. When the agent is also himself interested in the matter to be accomplished, it places him in a different relation to the principal; and the principal cannot at will destroy the relation. If, for instance, an agent is employed to sell a horse, and the agreement is that he is to advance the principal one-half the price and pay himself when he sells the horse, the principal cannot prevent him from selling the horse. The agent would have an interest in the matter himself, and could go on and do that which he had agreed to do.

The interest that causes a power of attorney to survive after death must be an interest in the subject matter of the agency and not in that which is produced by the exercise of the power.

Note:

1. An agent with an interest in the property itself cannot be discharged, as he is to that extent a partner with the principal.

REVIEW QUESTIONS

1. How may the contract of agency terminate? If an agent continues to act after his engagement has ended, does he bind his principal?
2. How is it possible to prevent an agent's going to work for a competitor when his engagement terminates? If the principal revokes the authority of his agent, who must be notified?
3. What is the general rule as to the death or insanity of the principal? Why? What is the rule as to compensation when the contract is terminated by the death or disability of the agent?
4. What is the effect of bankruptcy? Of insolvency? What is the distinction between bankruptcy and insolvency?
5. A borrowed money of B, giving B as collateral a power of attorney to collect certain rents. A died. Was B's power of attorney terminated? Is the tenant's obligation discharged by payment to B?
6. What is the effect when an agent has an interest in the subject matter? Why?

PART V
NEGOTIABLE INSTRUMENTS

CHAPTER XXVII

FORM AND INTERPRETATION¹

§ 153. The Quality of Negotiability

The negotiable instruments in ordinary use are: (1) promissory notes, (2) drafts or bills of exchange, and (3) checks. In all the states that have adopted the Uniform Bills of Lading Act, bills of lading are made negotiable instruments.

The *quality of negotiability* lies in the fact that any person, not an original party, who takes a negotiable instrument in the ordinary course of business, may sue on it when due, in his own name, and the person who is the obligor will be compelled to pay it. Negotiable instruments are also called "commercial paper."

Any ordinary contract may be assigned by executing an assignment, but in such case the assignee merely steps into the shoes of the person who assigned it, and if there has been any reason, as between the parties, why it should not be paid, this can be set up against the assignee, if he brings suit, exactly as if he were the original party. If this were true of a note, no one would dare to discount it, for, when the time of payment came, any reason for non-payment that might exist between the original parties could be used to destroy the whole value of the note. Hence, for the convenience of business, the law of negotiable instruments has grown up, to protect the man who takes them "in due course of business."

"In due course of business" means taken before its date for payment, for a valuable consideration and without knowledge of anything that would affect the title. The law says:

¹ For forms of negotiable instruments, see Chapter CIII, Forms 34-43.

A holder in due course holds the instrument free from defect of title of prior parties, and free from any defenses available to prior parties among themselves and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

Non-Negotiable Contracts. A simple agreement or promise to pay a sum of money could not be enforced unless there was a valid consideration for the promise, and an assignee would have no more rights than the original holder. That is, if suit were brought on such an agreement, and the maker could prove that no consideration had been given, he would not be made to pay. The same rule would hold as between the *original parties* to a note, and the defense of no consideration would prevent collection, but if the note or other negotiable paper had been negotiated, that is, if it had passed in the course of business into the hands of *an innocent holder for value*, the matter of consideration would not figure, and the full amount would have to be paid.

Notes, drafts, and checks are used so extensively that the laws governing their transfer are of great importance. When the subject of uniform laws was brought up, the law of negotiable instruments was the first to be reformed and the one most widely adopted. The Uniform Negotiable Instruments Law as devised by the commissioners having the work in hand has at the present time been adopted by every state and territory except Georgia and Porto Rico.

In discussing this subject, the Uniform Negotiable Instruments Law has been followed as closely as possible, and the quotations are from the text of the law.

The following are the requirements for negotiable instruments as laid down in the law itself:

§ 1.—An instrument to be negotiable must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer.
2. Must contain an unconditional promise or order to pay a sum certain in money.
3. Must be payable on demand, or at a fixed or determinable future time.
4. Must be payable to order or to bearer; and
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

§ 154. Signature

The signer of an instrument is liable, and anyone signing a trade-name or assumed name will be liable personally. A duly authorized agent can sign for his principal, and if he is duly authorized and signs as agent or in a representative capacity, he will not be personally liable. If, however, he signs as agent without disclosing his principal, he will be personally liable.

The indorsement of a corporation or an infant passes the property in the instrument, though the corporation or infant may not be liable. A note signed by a minor cannot be collected.

A forged signature is absolutely void and passes no right or title.

§ 155. Unconditional Promise

The Uniform Law allows two variations of the requirement of an unconditional promise or order to pay.

§ 3.—An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with:

1. An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or
2. A statement of the transaction which gives rise to the instrument.

But an order or promise to pay out of a particular fund is not unconditional.

§ 156. Certainty as to Sum

It is to be noted that the law allows certain variations as to the certainty of the sum:

§ 2.—The sum payable is a sum certain within the meaning of this act, although it is to be paid:

1. With interest; or
2. By stated instalments; or
3. By stated instalments, with a provision that upon default in payment of any instalment or of interest, the whole shall become due; or
4. With exchange, whether at a fixed rate or at the current rate; or
5. With costs of collection or an attorney's fee, in case payment shall not be made at maturity.

§ 157. Payable on Demand

§ 7.—An instrument is payable on demand:

1. Where it is expressed to be payable on demand, or at sight, or on presentation; or
2. In which no time for payment is expressed.

Where an instrument is issued, accepted or indorsed when overdue, it is, as regards the person so issuing, accepting or indorsing it, payable on demand.

§ 158. Certain Future Time

The law clearly expresses that the time must be certain.

§ 4.—An instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable:

1. At a fixed period after date or sight; or
2. On or before a fixed or determinable future time specified therein; or
3. On or at a fixed period after the occurrence of a specified event, which is certain to happen, though the time of happening be uncertain.

An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect.

§ 159. Payable to Order

§ 8.—The instrument is payable to order where it is drawn payable to the order of a specified person or to him or his order. It may be drawn payable to the order of:

1. A payee who is not maker, drawer or drawee; or
2. The drawer or maker; or
3. The drawee; or
4. Two or more payees jointly; or
5. One or some of several payees; or
6. The holder of an office for the time being.

Where the instrument is payable to order the payee must be named or otherwise indicated therein with reasonable certainty.

§ 160. Payable to Bearer

§ 9.—The instrument is payable to bearer:

1. When it is expressed to be so payable; or
2. When it is payable to a person named therein or bearer; or
3. When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable; or
4. When the name of the payee does not purport to be the name of any person; or
5. When the only or last indorsement is an indorsement in blank.

§ 161. The Date

The law provides that the date on the face of the instrument is presumed to be the true date, and that it may be ante-dated or post-dated, provided it is not done for a fraudulent purpose. It is also provided that if a date is left blank, any holder may insert the true date. If an instrument is issued with any material particular left out, the holder may fill in the blanks.

A note dated on a legal holiday other than Sunday is valid. In New Jersey a contract, bill, note, or check drawn or made, accepted or delivered, on Sunday is void. In Massachusetts a note or check made on Sunday is void as between the original parties. In Connecticut, a defense to an action on a note made on Sunday will be good if the consideration is restored. Both Massachusetts and Connecticut protect the bona fide holder of a note made, accepted or drawn on Sunday. In New York a note dated and delivered on Sunday is valid.

§ 162. Consideration

All negotiable paper is presumed to have been given for a valuable consideration, and everyone whose signature appears on it is presumed to have become a party for a valuable consideration. Any consideration that would support an ordinary contract will be sufficient. An existing debt would be a good consideration for a note or draft in settlement.

Absence or failure of consideration is not a good defense against a holder in due course for value.

If a gambling debt has been paid with a negotiable instrument, the maker can generally set up the defense of illegality only against the original party. In a few states, however, gambling contracts are absolutely void, and there the maker of such an instrument cannot be held, but the indorser can, inasmuch as an indorser warrants the legality of the instrument.

Anyone having a lien on a negotiable instrument, is a holder for value to the extent of his lien.

§ 163. Delivery

A negotiable instrument is incomplete until delivery. If an incomplete instrument is completed and delivered without authority of the maker or drawer, it will not be valid unless

it comes in due course to an innocent holder for value, in which case it will be presumed conclusively to be good.

§ 164. Rules of Construction

§ 10.—The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof.

§ 17.—Where the language of the instrument is ambiguous, or there are omissions therein, the following rules of construction apply:

1. Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, references may be had to the figures to fix the amount;

2. Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof;

3. Where the instrument is not dated, it will be considered to be dated as of the time it was issued;

4. Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail;

5. Where the instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it as either at his election;

6. Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser;

7. Where an instrument containing the words "I promise to pay" is signed by two or more persons, they are deemed to be jointly and severally liable thereon.

§ 165. Allowable Provisions

§ 5.—An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. But the negotiable character of an instrument otherwise negotiable is not affected by a provision which:

1. Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or
 2. Authorizes a confession of judgment if the instrument be not paid at maturity; or
 3. Waives the benefit of any law intended for the advantage or protection of the obligor; or
 4. Gives the holder an election to require something to be done in lieu of payment of money.
- But nothing in this section shall validate any provision or stipulation otherwise illegal.

§ 166. Non-Essentials

§ 6.—The validity and negotiable character of an instrument are not affected by the fact that:

1. It is not dated; or
2. Does not specify the value given, or that any value has been given therefor; or
3. Does not specify the place where it is drawn or the place where it is payable; or
4. Bears a seal; or
5. Designates a particular kind of current money in which payment is to be made.

But nothing in this section shall alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument.

REVIEW QUESTIONS

1. Give a succinct but clear idea of commercial paper. If the assignee of an ordinary contract has to bring suit to enforce it, what may happen? What is meant by "due course of business"?
2. What are the five requirements for negotiable instruments? What are the usual negotiable words?
3. How should an agent sign a note?
4. What effect has a minor's note? A minor's indorsement?
5. Would a note payable from "rents for March, 1919, from the maker's apartment house, No. 154 Clinton Avenue, Baltimore, Maryland," be negotiable?

6. Is a note payable in instalments good? Is a note good that adds costs of collection?
7. Would a note payable ninety days after the death of the maker be negotiable? What if it were payable ninety days after the payee came of age?
8. Is a note with no time expressed good?
9. Is a note or a check invalidated if dated on a legal holiday? Dated on Sunday? Explain fully.
10. A affixes his signature to a blank paper and delivers it to B for the purpose of converting it into a negotiable note. B writes a larger amount and a shorter time than agreed on. Is A liable to a holder in due course without notice?
11. C pays a note that apparently bears his signature as maker. Later he finds that the signature was forged. May he recover the money paid? State the principle.
12. A bank discounts a note having a genuine indorsement, but forged signature of maker. Who bears loss?
13. If in a note there is a conflict between words and figures as to sum payable, what prevails? As between printed words and written words which prevails?
14. Is it necessary that a note or a bill should contain the words "value received"? That it should be dated?
15. What provision can be made in a note as to the sale of collateral securities? What are "collateral securities"?

CHAPTER XXVIII

NEGOTIATION¹

§ 167. Method of Negotiation

§ 30.—An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery; if payable to order it is negotiated by the indorsement of the holder completed by delivery.

§ 31.—The indorsement must be written on the instrument itself or upon a paper attached thereto. The signature of the indorser, without additional words, is a sufficient indorsement.

§ 32.—The indorsement must be an indorsement of the entire instrument. An indorsement, which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more indorsees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue.

§ 168. The Indorser's Contract

The contract of any one who indorses negotiable instruments is that he warrants to all subsequent holders in due course:

1. That the instrument is genuine.
2. That he has good title to it.
3. That all prior parties had capacity to contract.
4. That the instrument is, at the time he indorses it, valid and subsisting.

¹ For forms of indorsement, see Chapter CIII, Forms 36, 44.

He also warrants that on presentment when due it will be accepted or paid or both according to its tenor, and that if it be dishonored and the necessary protest and notice be given, he will pay the amount thereof to the holder or to any subsequent indorser who may have to pay it.

§ 169. Blank or Special Indorsement

§ 33.—An indorsement may be either special or in blank; and it may also be either restrictive or qualified, or conditional.

§ 34.—A special indorsement specifies the person to whom, or to whose order the instrument is to be payable; and the indorsement of such indorsee is necessary to the further negotiation of the instrument. An indorsement in blank specifies no indorsee, and an instrument so indorsed is payable to bearer, and may be negotiated by delivery.

§ 35.—The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.

§ 170. Restrictive Indorsement

§ 36.—An indorsement is restrictive, which either:

1. Prohibits the further negotiation of the instrument; or
2. Constitutes the indorsee the agent of the indorser; or
3. Vests the title in the indorsee in trust for or to the use of some other person.

But the mere absence of words implying power to negotiate does not make an indorsement restrictive.

§ 37.—A restrictive indorsement confers upon the indorsee the right:

1. To receive payment of the instrument;
2. To bring any action thereon that the indorser could bring;
3. To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.

But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement.

§ 171. Qualified Indorsement

§ 38.—A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument. It may be made by adding to the indorser's signature the words "without recourse" or any words of similar import. Such an indorsement does not impair the negotiable character of the instrument.

§ 172. Conditional Indorsement

The payee is not concerned about a conditional indorsement. Such an indorsement affects the rights of only those who take the instrument after the indorsement. A conditional indorsement imposes some condition on payment, as "Pay to Henry Alford upon delivery of motor truck, on March 1, 1920. Mark Anderson."

In such a case, the payee may take no notice of the condition and may pay any lawful holder of the note whether the condition has been fulfilled or not. But any holder of such a note would hold it, or any amount paid him upon it, subject to the rights of the conditional indorser.

§ 173. Effect of Indorsement

An instrument payable to bearer may be indorsed specially to some particular person and after that may again be passed on by delivery.

§ 41.—Where an instrument is payable to the order of two or more payees or indorseees who are not partners, all must indorse, unless the one indorsing has authority to indorse for the others.

§ 42.—Where an instrument is drawn or indorsed to a person as "cashier" or other fiscal officer of a bank or corporation, it is deemed *prima facie* to be payable to the bank or corporation of which he is such officer; and may be negotiated by either the indorsement of the bank or corporation or the indorsement of the officer.

§ 43.—Where the name of a payee or indorsee is wrongly designated or misspelled, he may indorse the instrument as therein described, adding, if he think fit, his proper signature.

§ 44.—Where any person is under obligation to indorse in a representative capacity, he may indorse in such terms as to negative personal liability.

§ 45.—Except where an indorsement bears date after the maturity of the instrument, every negotiation is deemed *prima facie* to have been effected before the instrument was overdue.

§ 46.—Except where the contrary appears every indorsement is presumed *prima facie* to have been made at the place where the instrument is dated.

REVIEW QUESTIONS

1. What is the difference between assigning a simple contract, and negotiating a note or other commercial paper? What is the form?
2. What is a contract of indorsement? What obligation is assumed by the indorser?
3. If an instrument payable to bearer is indorsed specially to some particular person and after that is passed on by delivery, can the holder by delivery collect from the special indorser or the special indorsee?
4. Give pro forma illustrations of the following indorsements of promissory notes and show the purpose and effect of each indorsement: (a) in full, (b) conditional, (c) restrictive, (d) qualified.
5. What is the procedure where the name of a payee or indorsee has been misspelled or his initials are not given correctly?

CHAPTER XXIX

RIGHTS OF HOLDER

§ 174. Holder in Due Course

The Uniform Negotiable Instruments Law uses the phrase "a holder in due course" to express the idea of an innocent holder for value, that is, one who has taken the instrument without knowledge of anything unusual in connection with it and who has given a valuable consideration for his title. Such a holder of a negotiable instrument may sue on it in his own name.

§ 52.—A holder in due course is a holder who has taken the instrument under the following conditions:

1. That it is complete and regular upon its face;
2. That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such were the fact;
3. That he took it in good faith and for value;
4. That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

§ 53.—Where an instrument payable on demand is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course.

§ 54.—Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him.

§ 175. Defects of Title

§ 55.—The title of a person who negotiates an instrument is defective within the meaning of this act when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

§ 56.—To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

§ 176. The Rights of a Holder in Due Course

A holder in due course of a negotiable instrument is in a strong position. He has a good claim against any of the prior parties to the instrument regardless of any claim they may have for fraud, duress, lack of consideration, and, with a few exceptions, illegality. Of course, if the holder knew of any of these defects before taking the instrument, he would not be a holder in due course. If he occupies the position of holder in due course, he may take any negotiable instrument without inquiry and without any fear that in the event of having to bring suit he may meet with any of the defenses named.

§ 57.—A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

§ 177. Effect of Irregular Transfer

If a holder of negotiable paper not "a holder in due course" brings suit to collect, he must face all the defenses

that can be brought up in a suit between the original parties. There may have been fraud as between the original parties or other cause why the note should not be paid. If it has come into the hands of an innocent holder, he can collect notwithstanding, but if the holder did not take the instrument in due course, any of the defenses existing between the original parties may be used against him.

§ 97.—In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter.

If negotiable instruments payable to bearer are lost, the finder does not have good title, but if he manages to transfer them to an innocent holder for value, such holder has a good title. This rule does not apply to certificates of stock or other instruments that are only quasi-negotiable.

REVIEW QUESTIONS

1. What is a "holder in due course"? If a person takes an undated note, is he a holder in due course? If a note is overdue, will an indorsee be a holder in due course? If the indorsee pays only half the face of the note, will he be a holder in due course?
2. Distinguish the position of a bona fide holder of a negotiable instrument and an assignee of an assignable obligation in the event of their suing for their respective claims.
3. An indorsee who has notice of illegality of note indorses it to a bona fide holder for value, and takes up the note at maturity. Is he entitled to sue maker?
4. If A lost bearer bonds and certificates of stock indorsed in blank, and C took them from the finder in good faith, paying value, what interest would C have?

CHAPTER XXX

LIABILITY OF PARTIES

§ 178. Liability of Maker

The maker of a promissory note engages to pay the note he issues according to its tenor and effect, and he is primarily liable. Should it be paid by one of the indorsers, the maker will later have to reimburse him for what he has paid. The maker is liable even if the note is not presented to him when due. He remains liable upon it until it is outlawed by the Statute of Limitations. He is not liable on a forged instrument or on an incomplete instrument lost or stolen and filled out by the finder or thief.

§ 34.—Where an incomplete instrument has not been delivered it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery.

§ 42.—Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, and to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority.

§ 179. Liability of Indorser

When any person other than maker, drawer, or acceptor places his signature upon an instrument he is deemed to be an indorser.

§ 64.—Where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser in accordance with the following rules:

1. If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties.
2. If the instrument is payable to the order of the maker or drawer, or is payable to bearer, he is liable to all parties subsequent to the maker or drawer.
3. If he signs for the accommodation of the payee he is liable to all parties subsequent to the payee.

§ 65.—Every person negotiating an instrument by delivery or by a qualified indorsement, warrants:

1. That the instrument is genuine and in all respects what it purports to be;
2. That he has a good title to it;
3. That all prior parties had capacity to contract;
4. That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless.

§ 67.—Where a person places his indorsement on an instrument negotiable by delivery he incurs all the liabilities of an indorser.

The contract of the indorser, like that of the drawer, is a conditional promise to pay. The conditions are that the prior parties fail to pay and that due notice of their failure be given.

The amount of the indorser's liability is the face of the instrument, and in addition, interest and notary's protest fees.

Indorsers are liable in the order in which they indorse, but evidence may be admitted to show that they have agreed otherwise as between or among themselves.

§ 180. Discharge of Indorser

If the holder and maker agree to an extension of the time of payment, it will discharge any indorsers of the instru-

ment. Mere delay in bringing suit does not have this effect.

As set forth in subsequent chapters, failure to present the note for payment on the due date will discharge the indorsers, and if the note is presented for payment and not paid, the indorsers must be duly notified if they are to be held.

§ 181. Liability of Guarantor

If instead of the usual indorsement or indorsement in blank, a guaranty is made, as, "For value received, I hereby guarantee payment of within note, Warren Colwell," the effect is that the guarantor waives the usual presentment and notice of non-payment.

Some courts hold that this contract of guaranty is not strictly negotiable and will not pass to any but the next holder. The usual form of indorsement is in most cases preferable. A guarantor of collection instead of payment is liable only if the maker is sued promptly and then cannot by legal means be made to pay.

§ 182. Liability of Accommodation Signer

Accommodation paper is distinguished from business paper by lack of consideration. Thus a man may give his note to a friend, in order that the latter may discount it and so secure funds to meet a temporary emergency. In the same way he may write his acceptance upon a draft (see § 205), or indorse a note made by a friend in need of funds. The distinction is often made between real instruments and accommodation paper that the former represent past and the latter future transactions. In the first case, a man gives a note for goods received; in the second, he indorses a note in order that its maker may receive goods.

Since the one who is accommodated is not a holder for value, he cannot sue upon accommodation paper. But anyone who for accommodation signs his name to any negotiable

instrument as maker, drawer, acceptor, or indorser, is liable to any holder for value. The accommodation signer is liable even though the holder knows that he signed for accommodation and that he received no value. But an accommodation signer is never liable to the party accommodated.

REVIEW QUESTIONS

1. Give the liability, to holder in due course, of the maker and of the indorser of a promissory note.
2. What is the effect of indorsement of a negotiable instrument in this form, "Henry Baldwin, without recourse"?
3. How far is an indorser liable when the maker becomes insolvent and settles with his creditors for 50 cents on the dollar?
4. What action of the holder will discharge an indorser? What steps must be taken to hold indorsers?
5. A deposits grain at an elevator and takes a negotiable receipt which he sells to B. Then A gets the grain by misrepresentation from the warehouseman and sells to C. Would B have any claim on C? What rights would B have?
6. How does a guarantor of negotiable paper differ from an indorser?
7. The holder of a demand note agreed that he would not transfer the note or put it in the bank for collection, but would hold it till such time as he wanted the money, and would then make demand for it. Upon this the defendant, at the maker's request, indorsed the note. The plaintiff forbore suit for over two years. Is the indorser liable? State the legal principle involved.
8. Directors of a company indorse its note to enable it to make a loan. The note is paid by the first indorser. What claim for indemnity has he against the subsequent indorsers?
9. A signs what he thinks is a subscription blank for a set of books, in reality the paper is a cleverly contrived promissory note. This note is negotiated. It passes into the hands of a purchaser for value. In your state can this holder force the maker to pay the note?

10. B is induced to buy an automobile by false representation. He gives a note in part payment. When he finds that he has been defrauded, he notifies the payee that he will not pay the note, but meanwhile the payee has negotiated the note to another, who is an innocent purchaser for value. Can the latter force B to pay the note?
11. C dates a check and signs his name, but does not fill out the other spaces. The check is stolen and filled out by the thief. It passes into the hands of an innocent party who pays value. Will that party be able to collect the check from C?

CHAPTER XXXI

PRESENTMENT FOR PAYMENT

§ 183. Necessity of Presentment

The maker or acceptor of a negotiable instrument is liable without presentment for payment, but if the drawer and indorsers are to be held, it must be presented for payment.

Presentment must be made on the due date except in the case of demand paper which must be presented within a reasonable time. "Days of grace" were three extra days which were formerly allowed for the payment of commercial paper.

§ 184. Requirements for Presentment

§ 72.—Presentment for payment, to be sufficient, must be made:

1. By the holder, or by some person authorized to receive payment on his behalf;
2. At a reasonable hour on a business day;
3. At a proper place as herein defined;
4. To the person primarily liable on the instrument, or if he is absent or inaccessible, to any person found at the place where the presentment is made.

§ 73.—Presentment for payment is made at the proper place:

1. Where a place of payment is specified in the instrument and it is there presented;
2. Where no place of payment is specified, but the address of the person to make payment is given in the instrument and it is there presented;
3. Where no place of payment is specified and no address is given and the instrument is presented at the usual place of business or residence of the person to make payment.

4. In any other case if presented to the person to make payment wherever he can be found, or if presented at his last known place of business or residence.

§ 74.—The instrument must be exhibited to the person from whom payment is demanded, and when it is paid must be delivered up to the party paying it.

If the instrument is payable at a bank, presentment must be made during banking hours unless payee has no funds there, in which case any hour before the closing of the bank will do. If the bank holds such a note for collection and it is in the bank on its due date, no other presentment is necessary.

Speaking generally, it is the bank's duty to use all diligence in respect to negotiable paper left with it for collection. This involves prompt presentation for acceptance if acceptance is necessary; and presentation for payment on the date of payment within banking hours, at the place specified in the instrument, if any, and if not, at the maker's place of business. In case the instrument is not paid on presentation when due, it is the bank's duty to protest it, if not otherwise instructed by the owner, and to give due notice of its dishonor to all indorsers, and to do any other things necessary for the collection of the instrument. The bank is liable for any failure in its performance of its duty.

§ 185. Presentment Excused

§ 82.—Presentment for payment is dispensed with:

1. Where, after the exercise of reasonable diligence presentment as required by this act cannot be made;
2. Where the drawee is a fictitious person;
3. By waiver of presentment, express or implied.

§ 186. When Due

§ 85.—Every negotiable instrument is payable at the time fixed therein without grace. When the day of maturity falls upon Sunday or a holiday, the instrument is payable on the

next succeeding business day. Instruments falling due on Saturday are to be presented for payment on the next succeeding business day, except that instruments payable on demand may, at the option of the holder, be presented for payment before twelve o'clock noon on Saturday when that entire day is not a holiday.

§ 86.—Where the instrument is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the date of payment.

If an instrument is due a month or more after date, a calendar month is meant. A note dated February 16 and due a month from date will fall due on March 16, whether in leap year or any other year.

REVIEW QUESTIONS

1. What were "days of grace" as understood in the law relating to commercial paper?
2. What is the legal effect of failure to make presentment for payment on the due date of a promissory note?
3. What is a bank's liability with reference to negotiable papers left with it for collection?
4. A note held by the bank at which it is payable is not paid at maturity. Must there be a presentment and demand of payment?
5. How is the due date of commercial paper determined? What is the rule if the due date falls on a holiday? On a Saturday?
6. How should presentment be made?
7. Why is the maker or acceptor liable even though the instrument is not presented on the due date?
8. Would it be proper under any circumstances to present a note for payment to the maker, who was walking along the street?
9. If the maker cannot be found, what is the situation?

CHAPTER XXXII

NOTICE OF DISHONOR

§ 187. Necessity of Notice

§ 89.—Except as herein otherwise provided, when a negotiable instrument has been dishonored by non-acceptance or non-payment, notice of dishonor must be given to the drawer and to each indorser, and any drawer or indorser to whom such notice is not given is discharged.

The holder must give notice. If the note has been left with a bank for collection, it as agent for the holder would give notice. If the note has been given to a notary for protest, he usually gives the required notice.

§ 188. Effect of Notice

§ 92.—Where notice is given by or on behalf of the holder, it enures for the benefit of all subsequent holders and all prior parties who have a right of recourse against the party to whom it is given.

§ 93.—Where notice is given by or on behalf of a party entitled to give notice, it enures for the benefit of the holder and all parties subsequent to the party to whom notice is given.

§ 189. Form of Notice

The notice may be informal provided it is so clear as not to mislead the party to whom it is sent. It may even be oral. It may be delivered personally or by mail. It may be given to the party or to someone acting as his authorized agent.

§ 190. Time of Notice

Where both parties reside in the same place, the time when notice must be given is as follows:

§ 103.—1. If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following;

2. If given at his residence, it must be given before the usual hours of rest on the day following;

3. If sent by mail, it must be deposited in the post-office in time to reach him in usual course on the day following.

If the parties reside in different places, the rule is as follows:

§ 104.—1. If sent by mail, it must be deposited in the post-office in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on that day, by the next mail thereafter.

2. If given otherwise than through the post-office, then within the time that notice would have been received in due course of mail, if it had been deposited in the post-office within the time specified in the last subdivision.

Where a notice is duly deposited in the post-office, within the specified time, it is deemed a good notice, whether or not it reaches its destination.

The party receiving notice is allowed the same period of time to send notice to antecedent parties that was permitted to the last holder.

§ 191. Where to Send Notice

If the party has given an address, notice should be sent there; otherwise—

§ 108.—1. Either to the post-office nearest to his place of residence, or to the post-office where he is accustomed to receive his letters; or

2. If he lives in one place, and has his place of business in another, notice may be sent to either place; or

3. If he is sojourning in another place, notice may be sent to the place where he is so sojourning.

But where the notice is actually received by the party within the time specified in this act, it will be sufficient, though not sent in accordance with the requirements of this section.

Delay in giving notice is excused when caused by circumstances beyond the control of the holder.

§ 192. When Notice Is Not Required

Notice of dishonor is not required to be given to the drawer in the following cases:

§ 114.—1. Where the drawer and drawee are the same person;

2. Where the drawee is a fictitious person or a person not having capacity to contract;

3. Where the drawer is the person to whom the instrument is presented for payment;

4. Where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument;

5. Where the drawer has countermanded payment.

§ 193. Protest

A protest is practically a certificate by a notary that the instrument has been presented, a demand for payment made, and such demand refused, and that the notary has protested against such non-payment and has sent notice of such protest and non-payment to the party concerned. This is followed by the official signature and seal of the notary. The object of protest is to hold those secondarily liable. The acceptor of a draft and the maker of a note, are principal debtors and are held with or without protest.

Foreign bills of exchange must always be protested, as

the notary's certificate is the only admissible evidence of the bill's dishonor.

In case a bank protests a draft ahead of time, it is liable to the acceptor for injury to his credit.

Any negotiable instrument may be protested for non-acceptance or non-payment, but such procedure is not legally required, except for foreign bills of exchange. The costs of a protest are added to the amount to be paid by any party liable on the instrument. Fees for protest are fixed by statute. Protest is advisable, as the notary will send the required notice and put the evidence of non-payment and due notice in the best possible shape for use, if litigation results.

If it is desired to avoid the expense of protest, it is necessary to attach notice of "No Protest" to any instrument sent through a bank for collection, otherwise the bank will give its notaries a chance to make fees.

REVIEW QUESTIONS

1. Notice of dishonor is to be given by whom? To whom must notice be sent?
2. What is the effect if notice is not given?
3. What is the rule as to the time of notice: (a) Where the parties live in the same place? (b) Where they reside in different places?
4. If notice was sent by mail and owing to a train wreck the letter was destroyed, would the person to be notified be released?
5. Who pays the cost of protest? What does the term "protest" mean?
6. E holds an unpaid note and gives due notice to fourth indorser, who gives due notice to second indorser, who gives due notice to first and third. Who are liable to E?
7. What form of negotiable instruments legally require protest and for what defaults?

CHAPTER XXXIII

DISCHARGE OF NEGOTIABLE INSTRUMENTS

§ 194. When Discharged

A negotiable instrument is discharged:

- § 119.—1. By payment in due course by or on behalf of the principal debtor;
2. By payment in due course by the party accommodated, where the instrument is made or accepted for accommodation;
3. By the intentional cancellation thereof by the holder;
4. By any other act which will discharge a simple contract for the payment of money;
5. When the principal debtor becomes the holder of the instrument at or after maturity in his own right.

A person secondarily liable on the instrument is discharged:

- § 120.—1. By an act which discharges the instrument;
2. By the intentional cancellation of his signature by the holder;
3. By the discharge of a prior party;
4. By a valid tender of payment made by a prior party.

Also by release of the principal debtor or by extension of his time of payment. Merely letting the time of payment go by without beginning suit is not granting an extension.

§ 195. When Not Discharged

When paid by a party other than the maker or drawee, the instrument is not discharged, but the party paying it may enforce payment against all prior parties on the instrument.

§ 196. Effect of Alteration

Any material alteration, unless made with the assent of all parties concerned, will invalidate the instrument, except as against the parties who made the alteration.

Any alteration is material which changes:

- § 125.—1. The date;
- 2. The sum payable, either for principal or interest;
- 3. The time or place of payment;
- 4. The number or the relations of the parties;
- 5. The medium or currency in which payment is to be made;

Or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect. . . .

REVIEW QUESTIONS

1. How is liability of indorser affected when maker and holder agree to extend time of payment?
2. If an indorser pays a note to avoid suit, what rights has he?
3. An instrument which has been materially altered is in due course in the hands of a holder not a party to the alteration. May he enforce payment according to original tenor?
4. What alterations in negotiable instruments are material?
5. A negotiable note executed and delivered by A to B passes in due course to and is indorsed in blank by B, C, D, and E. F is the last holder and strikes out C's indorsement. What is the liability of C, D, and E?
6. Under what circumstances is an indorser relieved from liability as such?

CHAPTER XXXIV

PROMISSORY NOTES

§ 197. Definition

A note is described and defined by the Uniform Negotiable Instruments Law as follows:

1. It is a written promise without condition,
2. By the maker to another, or to the maker's order,
3. To pay a sum certain in money to order or to bearer,
4. On demand at a fixed or determinable future time.

§ 184.—A negotiable promissory note within the meaning of this act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer. Where a note is drawn to the maker's own order, it is not complete until indorsed by him.

§ 198. Liability of Maker

The liability of the maker of a promissory note may vary in nine different ways as follows: ¹

1. Where the note is signed with his name by another at his direction, he is liable in the same manner as though he had personally signed the note.
2. Where he signs and delivers the note without consideration to the party who seeks to enforce it, he is not liable if he raises the question and properly makes the defense of lack of consideration.

¹ C. P. A. Problems, Vol. I, page 235. This differentiation of liability is far-fetched and even fantastic. It is brought in here only because required to answer a question actually asked.

3. Where he signs and delivers the note without consideration and it subsequently comes into the hands of a holder in due course, he is liable.
4. Where his signature is forged by the party who seeks to enforce it, he is not liable.
5. Where his liability is sought to be enforced by one to whom it was negotiated for value by the party forging his signature, he may set up that the instrument was forged even against a holder in due course.
6. Where the instrument sued on is not dated, does not state that it is given for value, and does not specify the place where it is drawn or the place where it is payable, he is liable.
7. Where the holder of the note has, without the assent of the maker, changed its date, he is not liable on the note either in its present or its original form. Alteration of date is a material alteration.
8. Where the holder of the note has, without the assent of the maker, changed its place of payment, he is not liable. Place of payment is a material term of the note.
9. Where the holder of the note has unintentionally marked it cancelled, he is liable, provided the holder can prove that the cancellation *was* unintentional. The burden of proof is on the holder.

§ 199. Interest

The holder of a note on which interest is payable at fixed periods need not protest or take any action in case of default of interest payments. He may simply wait until the principal is due and then proceed to collect the whole amount of the note.

The legal rate of interest at the place where payment is to be made will determine the rate if not specified in the note.

§ 200. Demand Notes

If an indorser on a demand note is to be held, payment must be demanded within a reasonable time; the maker will be bound even if demand is not made for a very long time. The only limitation protecting the maker is that imposed by the Statute of Limitations. It is held that the statute begins to run from the time a cause of action accrues. In the case of a demand note, this is from the time the note is delivered by the maker to the payee.

§ 201. Effect of Renewal

If a new note is taken in exchange for an unpaid one, it operates only as a suspension of the old debt, not as an extinguishment of it, unless by special agreement. In case the new note is not met, the old note may be sued upon. This is true whether or not the old note is retained by the creditor.

§ 202. Note as a Gift

If a gift is made of a promissory note payable to the order of the donee, and he should indorse it and transfer it to an innocent holder for value, it would be good. The donee could not collect by suit himself because he would be met by the defense of no consideration.

If the note were made payable to the donor's order and he indorsed it in blank, the immediate party who received it and gave no value in return could not enforce payment of the note.

REVIEW QUESTIONS

1. If a note is given to A and the donor dies, can A collect? If A has discounted the note at the bank can the bank collect?
2. What are the essentials of a promissory note?
3. The holder of a demand note failed to present it for two years. Then the maker had vanished. Could the holder collect from the indorsers?
4. What are nine different ways in which a note may be issued or handled, and the varying liabilities of the maker in each case?

CHAPTER XXXV

BILLS OF EXCHANGE AND ACCEPTANCES¹

§ 203. Definition

§ 126.—A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum in money to order or to bearer.

An inland bill is one drawn and payable within the state. Any other is a foreign bill. A bill of exchange when accepted becomes an acceptance.

A draft is an order to pay money—it includes bills of exchange, checks and all other forms of orders to pay money.

§ 204. Liability of Maker, Drawer, and Acceptor

The maker of a draft is called the drawer. He is analogous to the maker of a note. The maker of a promissory note engages to pay the note he issues according to its tenor and admits the existence of the payee and his capacity to indorse. The drawer of a draft assumes the same liability, if it is not paid by the drawee and the necessary proceedings on dishonor are taken. A draft may be presented to the drawee before payment to make sure that he will accept its obligations.

§ 205. Acceptance

§ 132.—The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It

¹ For forms see Chapter CIII, Forms 42-44.

must not express that the drawee will perform his promise by any other means than the payment of money.

An acceptance is an engagement to pay a bill of exchange as requested by the drawer. An acceptance is usually according to the tenor of the bill, in which case it is called a general or absolute acceptance.

Qualified Acceptance. A qualified acceptance is sometimes given.

§ 141.—An acceptance is qualified which is:

1. Conditional; that is to say, which makes payment by the acceptor dependent on the fulfillment of a condition therein stated;
2. Partial; that is to say, an acceptance to pay part only of the amount for which the bill is drawn;
3. Local; that is to say, an acceptance to pay only at a particular place;
4. Qualified as to time;
5. The acceptance of some one or more of the drawees, but not of all.

The holder may require that the acceptance be written on the bill. It should not be written on another piece of paper. The drawee has twenty-four hours to decide whether he will accept or not. If he destroys the bill or fails to return it, he will be held to have accepted it.

Mode of Acceptance. Upon presentation of the bill of exchange, the drawee, if he wishes to pay the order according to its terms, may do so by writing across its face the word "Accepted," followed by signature and date. When this is done by the drawee he becomes the acceptor, and thereby agrees to pay the bill at maturity, according to its tenor, without qualifying conditions.

Effect of Acceptance. The effect of the acceptance of a bill of exchange is to constitute the acceptor the principal debtor. The bill of exchange becomes, by the acceptance,

similar to a promissory note—the acceptor being the promissor, and the drawer standing in the relation of an indorser or surety.

§ 206. Dollar Acceptance

By the term “dollar acceptance,” as used in international trade, is meant an accepted bill of exchange drawn in American dollars. The term has become familiar in this country since the enactment of and amendments to the federal reserve banking law, which created a system of modern bills of exchange for American business. Prior to the establishment of this system, it was the usual custom to draw bills of exchange in pounds sterling. Most of the international trade was financed through London; that is to say, financial institutions of London granted to traders acceptance credits which authorized the drawing of bills of exchange on such institutions. By this agreement, the trader was assured that the London bank would accept his bill. Thus, such institutions lent their *credit*, for which they charged a commission, and a merchant in London or even in South America would deal with both his creditors and his debtors in this country in terms of pounds sterling.

Under the amendment of September 7, 1916, to the Federal Reserve Act, in addition to the power to accept bills involved in the exportation and the importation of goods, federal reserve banks have the power to accept bills drawn upon them by foreign banks or bankers in the same way that London banks accommodate foreign traders. The reserve banks may accept drafts or bills of exchange drawn upon them, having not more than three months to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board, by banks or bankers in foreign countries or dependencies or insular possessions of the United States, for the purpose of furnishing dollar exchange as re-

quired by the usages of trade in the respective countries, dependencies, or insular possessions.

It is likely that in years to come New York will be as important financially and commercially as London; and, as the use of a decimal currency has much to recommend it, there is good reason to believe that the future will see dollar exchange more generally used than sterling exchange has been in the past. It is certain that every business man should understand clearly what is meant by "dollar acceptances," and its synonyms "dollar exchange," and "dollar credits," as the terms are used by bankers.

§ 207. Bank Acceptances

Under the federal reserve law, *member* banks of the federal reserve system are empowered to grant bankers' acceptance credits; that is to say, "Any member bank may accept drafts or bills of exchange drawn upon it and growing out of transactions involving the importation or exportation of goods having not more than six months' sight to run."² A bankers' acceptance, as defined by the Federal Reserve Board, "is a bill of exchange of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged in the business of granting bankers' acceptance credits."

When the bank, trust company, firm, person or corporation, accepts the bill of exchange, it has loaned its credit, not its funds. The direct responsibility for the payment of the bill of exchange that has become an acceptance, rests on the bank or concern granting the acceptance credit. Such accepted bills of exchange are payable in our country and hence are known as "dollar acceptances."

§ 208. Domestic Bank Acceptances

The rules of the Federal Reserve Board are somewhat more rigid with regard to bank acceptance credits covering

² § 13 of the Federal Reserve Act.

domestic shipments. Such acceptances are used mainly to finance domestic transactions involving major staples. And the federal reserve law provides that "Any member bank (of the federal reserve system) may accept drafts or bills of exchange drawn upon it, having not more than six months' sight to run, exclusive of days of grace . . . which grow out of transactions involving the domestic shipment of goods, *provided* shipping documents³ conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples."

Such acceptances are known as dollar acceptances against domestic shipment of goods, or domestic bank acceptances.

§ 209. Trade Acceptances

In this country most of the credit business has been done on the open-account system whereby goods are sold at thirty, sixty, or ninety days, or in many cases without any definite time of payment. This system has many disadvantages. It compels the seller to carry the financial burden of the buyer and so ties up his capital for an indefinite period. Also, the expense involved in collecting slow accounts and granting extensions constitutes in the aggregate a heavy tax on business. All these disadvantages are eliminated by the use of the trade acceptance.

A trade acceptance is a bill of exchange drawn by the seller directly on the purchaser of goods, and accepted by the purchaser. The direct responsibility for the payment of the bill rests on the person, firm or corporation accepting the bill of exchange. The Federal Reserve Board has defined the

³ "Shipping documents" are all the documents required to prove title to the shipments—the bill of lading, insurance policy, consular invoice, and so on. *Principles of Foreign Trade*. Savay, page 306.

trade acceptance as a "bill of exchange, drawn by the seller on the purchaser, of goods sold and accepted by such purchaser."

Functions of the Trade Acceptance. Trade acceptances are instruments of credit, and when properly created are eligible for purchase by federal reserve banks. They thus add to the circulating medium, just as do eligible bank acceptances.

The extensive use of the trade acceptance in American business is urged as a remedy to cure the defects of the open-account system, as it provides the seller with an instrument which he may sell to his bank, broker, or other persons engaged in discounting such commercial paper, thus enabling him to keep liquid and mobile the capital that would otherwise be tied up in open book accounts.

§ 210. The Discount of Acceptances

Under Section 14 of the federal reserve banking law, and under rules and regulations prescribed by the Federal Reserve Board, federal reserve banks may purchase and sell in the open market bankers' acceptances and bills of exchange from banks, firms, corporations, or individuals.

It should be borne in mind that federal reserve banks proper do not "accept" bills of exchange, but may purchase acceptances in the open market (discount them), or may rediscount eligible acceptances for member banks.

§ 211. Rules for Discount of Bank Acceptances

§ 182.—A bankers' acceptance may be discounted with any federal reserve bank, under the following rules prescribed by the Federal Reserve Board:

1. The acceptance must have maturity at purchase of not more than three months.
2. The bill must have been drawn under credit opened

for the purpose of taking care of transactions involving

- (a) Foreign shipment of goods,
 - (b) Shipment within United States, provided bill is accompanied by shipping documents, or
 - (c) Storage within United States of readily marketable goods, provided acceptor is secured by proper receipt, or
 - (d) Storage within United States of goods actually sold, provided the bill is secured by pledge of such goods.
3. Or the bill must be drawn by a foreign bank or banker for the purpose of furnishing dollar exchange.

§ 212. Rules for Discount of Trade Acceptances

Federal reserve banks may purchase trade acceptances under the following rules prescribed by the Federal Reserve Board:

The bill must have arisen out of an actual commercial transaction, domestic or foreign; that is, it must be a bill which has been issued or drawn for agricultural, industrial, or commercial purposes or the proceeds of which have been used or are to be used for the purpose of producing, purchasing, carrying or marketing goods in one or more of the steps of the process of production, manufacture or distribution. It must have a maturity at time of purchase of not more than ninety days, exclusive of days of grace.

The word "goods" has been construed as meaning goods, wares, merchandise and all agricultural products including live stock.

§ 213. The Drawee

The drawee is not liable unless and until he accepts the bill. A bill may be addressed to two or more drawees, but not in the alternative, or in succession.

Where drawer and drawee are the same person, or the drawee is fictitious, or where the instrument is ambiguous, the holder may consider the instrument either a promissory note or a bill of exchange at his option.

§ 214. Presentment for Acceptance

Presentment for acceptance must be made:

§ 143.—1. Where the bill is payable after sight or in any other case where presentment for acceptance is necessary in order to fix the maturity of the instrument; or

2. Where the bill expressly stipulates that it shall be presented for acceptance; or

3. Where the bill is drawn payable elsewhere than at the residence or the place of business of the drawee.

In no other case is presentment for acceptance necessary in order to render any party to the bill liable.

Presentment for acceptance follows the general rules given for presentment for payment. (See Chapter XXXI.)

§ 215. Protest for Non-Acceptance

A foreign bill *appearing on its face to be such* must be protested on the day of its dishonor by non-acceptance, if the owner desires to hold the drawer and indorsers.

§ 153.—The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify:

1. The time and place of presentment;

2. The fact that presentment was made and the manner thereof;

3. The cause or reason for protesting the bill;

4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found.

§ 154.—Protest may be made by:

1. A notary public; or

2. By any respectable resident of the place where the

bill is dishonored, in the presence of two or more creditable witnesses.

§ 157.—A bill which has been protested for non-acceptance may be subsequently protested for non-payment.

Acceptance for Honor. An outside party may accept or pay a bill of exchange to save the credit of the drawee. In such case the acceptor makes himself liable, and if he must pay the bill, he has a right to be reimbursed by the person who should have paid it.

A bill payable in a foreign country would be protested according to the law of that country, and not according to the law of the place where the bill was made.

§ 216. Bills in a Set

§ 177.—Where a bill is drawn in a set, each part of the set being numbered and containing a reference to the other parts, the whole of the parts constitute one bill.

In such a case, the acceptance should be written on one of the sets and on one part only. If the drawee accepts more than one part, he may be held liable on each part as if it were a separate bill.

Usually, "where any one part of a bill drawn in a set is discharged by payment or otherwise, the whole bill is discharged."

When the acceptor of a bill drawn in a set pays it without requiring the part bearing his acceptance to be delivered up to him, and the part at maturity is outstanding in the hands of a holder in due course, he is liable to the holder thereon.

REVIEW QUESTIONS

1. What is a bill of exchange? An inland bill? A foreign bill? An acceptance? A draft?
2. What is a general acceptance? A qualified acceptance? What is the form of acceptance? Its effect?
3. What is meant by "dollar acceptances"? Why is the term significant?
4. What is a "bankers' acceptance" as defined by the Federal Reserve Board? What is necessary to make a bankers' acceptance eligible for discount at a federal reserve bank?
5. What are domestic bank acceptances?
6. What are trade acceptances? What are their functions? What is necessary to make a trade acceptance eligible for discount at a federal reserve bank?
7. When is presentment for acceptance of a bill of exchange necessary? What is the effect if such a bill is not presented?
8. What must protest of a foreign bill of exchange specify in order to hold drawer and indorsers? Who can protest a bill? Must a bill payable in a foreign city be protested by the law of the place where it is payable or by our Negotiable Instruments Law?
9. When bills are drawn in a set, what is the duty of the acceptor?
10. When must bills of exchange be presented for acceptance?
11. What is the rule as to protest of foreign bills of exchange?

CHAPTER XXXVI

BANK CHECKS

§ 217. Definition

A check may be defined as an unconditional order on a bank or a banker to pay on demand a specified sum to a person named or to his order, or to the bearer.

§ 185.—A check is a bill of exchange drawn on a bank, payable on demand. Except as herein otherwise provided, the provisions of this act applicable to a bill of exchange payable on demand apply to a check.

§ 218. Checks as Evidence of Payment

At the present time bank checks are used extensively as a substitute for cash payments. Few business men pay bills except by check. If actual money had to be constantly in transfer from one person to another, it would limit the amount of business that could be done at one time as the volume of cash in circulation is not adequate. The use of checks is an elastic medium of exchange that meets any possible demand of modern business.

The use of checks for the payment of debts affords the very best possible evidence of the fact of payment. A check given to pay a debt can only be cashed by the indorsement of the recipient, and his indorsement is the best evidence that he received the check and collected the money. This important function has been amplified in modern accounting by the use of voucher checks. A voucher check contains a clear statement of the exact obligation that the check is intended to

pay. Anyone who accepts a check with the statement on the check of the purpose to which the payment is to be applied is estopped thereafter from applying the payment to any other obligation or indebtedness. These checks are found in many forms.

The chief difference between an ordinary bill of exchange and a check is that the latter is always drawn on a bank and is always payable on demand. In addition, these points of difference are to be noted:

1. Grace is not allowed on a check.
2. The check must be drawn on funds actually in the bank.
3. The death of the drawer of a check revokes it.

§ 219. Signature of Drawer

The signature of the drawer is necessary, but it need not be placed at the bottom of the instrument. The order may be written under the signature, or some form such as "I, Henry Adams, direct you to pay to, etc.," may be used. The bank will have the signature on file and will be able to verify it in whatever form it occurs.

§ 220. Presentment for Payment

§ 186.—A check must be presented for payment within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay.

Thus if the holder keeps the check two weeks, and the bank fails before the check is presented, the liability of the drawer will be reduced in proportion to his total loss. That is, if the bank paid depositors only forty cents on the dollar, the holder of the check would be able to get only 40 per cent of its amount from the drawer. The courts will hold that

the other 60 per cent was lost to the holder by his own unreasonable delay. That is, the drawer is discharged from his liability to the holder only to the extent of the actual loss caused by the delay.

If the check must be sent to another place for collection, it should be started on the day following its receipt, and should go by a reasonably direct route. In some states it has been held that unreasonable delay is caused by sending a check over an indirect route through various correspondent banks.

§ 221. Bank's Relations with Depositor

The depositor in effect lends money to the bank, and the bank promises to repay it on demand. The bank is in no sense a trustee, unless there has been an express agreement to that effect.

The bank may charge against a depositor's account any notes of his which it holds and which are due. If the depositor has made an overdraft, the bank may apply subsequent deposits against it. A bill or note made payable at a bank authorizes the bank to pay it when due out of the depositor's account.

If the funds of a depositor on hand are not enough to pay a check in full, the bank need not pay it in part, but it may legally do so.

If the bank wrongfully refuses payment of a check, the drawer may sue for damages. If he is a business man and can prove that his credit has actually been injured, he may recover a substantial sum.

In general practice, a bank does not, except by special arrangement, take checks of depositors for collection, but accepts them outright for deposit. By this method the depositor is able to draw checks against his deposits without waiting until the bank has made sure that they can be collected. On the other hand, if the depositor does not wait a reasonable time for the collection of the checks he has deposited before

drawing against them, the bank may legally refuse to honor his checks.

If a depositor gives a check dated some days ahead and it is presented to the bank before its date, the bank will pay it or certify it at its own peril.

§ 222. Bank's Relations with Holder

§ 189.—A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check.

The holder of an uncertified check has ordinarily no rights against the bank. If the bank refuses to pay when it has funds of the drawer on hand, the depositor may sue the bank for damages to his credit, but the holder's recourse is only against the drawer of the check.

Even if the bank knows that the check was given for an illegal consideration, as in payment of a wager, the bank must cash it, and the drawer will have no claim against the bank for so doing. The bank will pay checks in the order of their presentment. If two or more checks are presented at the same time, the bank may pay in whatever order it pleases.

§ 223. Revocation

The drawer has the right to stop payment on a check, and if the bank pays the check after it has been notified not to do so, it will be liable. The drawer alone has a legal right to order payment stopped, but a subsequent indorser who knows of fraud ought to inform the bank at once if he cannot reach the drawer. In such a case the bank will probably delay payment of the check until the matter has been cleared up.

Even though the drawer is successful in stopping payment

of a check, he will be liable to an innocent holder for value if the indorsements are proper.

After a check has been certified, payment may not ordinarily be stopped.

The death of the drawer will revoke a check, but the bank must have notice, on the general principle that agency ceases only after the agent has received notice. Insolvency, when the bank is notified of it, also acts as a revocation.

§ 224. Certification

When a bank certifies a check, it assumes the obligation formerly held by the drawer. The bank will not certify unless it accepts the signature of the drawer as correct, and unless it has funds of the drawer on hand with which to pay; and as soon as it certifies it sets aside the proper amount from the drawer's account and holds it for the holder of the check. Under the Negotiable Instruments Law certification must be in writing. There is no legal obligation on a bank to certify any check for anybody. It is a matter of courtesy and convenience.

§ 187.—Where a check is certified by the bank on which it is drawn, the certification is equivalent to an acceptance.

§ 188.—Where the holder of a check procures it to be accepted or certified, the drawer and all indorsers are discharged from liability thereon.

Acceptance or certification of a check discharges the drawer, but if the drawer takes his own check to the bank for certification, he still remains secondarily liable, in case the certification be refused for any reason, or the bank becomes insolvent.

If a bank becomes insolvent, the holder of a certified check simply ranks among the other creditors.

§ 225. Fraud

The bank's agreement with the depositor is that it will pay out money on his account only on his order. If it honors a forged signature, therefore, it must bear the loss. But in New York, if a bank is not notified within one year after the return of a forged or raised check it cannot be held liable. The bank's liability is to the drawer, not to the payee or subsequent indorsers.

The drawer cannot hold the bank for a loss if he has been negligent in drawing the check or has delivered the check to the wrong person, or if he has signed and allowed to go into circulation a check with unfilled blanks, or if he has so negligently filled in a check that insertions might readily be made. The depositor should always examine his pass-book and vouchers carefully, and report promptly any errors he may discover. The bank will not be liable to a drawer whose acts amount to acquiescence in what the bank has done.

If a raised check is paid by a bank, it must bear the loss as against the drawer, unless his negligence in filling in the amounts made possible the forgery. As against the person to whom the money has been paid, the bank must bear the loss unless he was a party to the forgery or unless he can return the money to the bank without making his situation worse than it would have been had the bank refused payment. That is, if the payee has not yet done anything that he would not have done if payment had been refused, the bank may recover. In most cases, however, he will have delivered goods, given up security or otherwise have done something that he would not have done if the bank had refused payment.

If the amount is altered and the bank pays out money in good faith, it will be able to recover from the one who got the money. Even in case of alteration before certification, the bank will be able to recover from the one to whom payment was made. In case a check is raised after certification, if the

bank's carelessness was not responsible for the alteration or the payment, it will be able to recover the excess paid from an innocent holder to whom it paid the raised amount. Recovery is allowed in these cases because the bank is not supposed to warrant the body of the instrument by certifying it, but only the drawer's signature, the sufficiency of the funds, the existence of the payee and his capacity to indorse. In New York and Pennsylvania the bank's certification is a warrant only of the signature and the funds.

The bank after certifying a check will be liable to a holder in good faith, even though the funds are insufficient or the signature is forged. It will be liable also to such a holder even though the payee is fictitious or the blanks fraudulently filled. If a certified check has been stolen or lost, even though advertised, a holder in good faith will be able to recover.

An overdraft is not usually a criminal offense. If a man draws a check out with intent to defraud and with knowledge that he has no right to draw on the bank for the amount he does, he is guilty of stealing and is punishable accordingly.

§ 226. Checks as Gifts

If a check is given as a present, it will be valid, and subject to the defense of no consideration only as between the donor and donee. A check given as a gift *causa mortis* if not cashed or certified before the death of the donor, is revoked.

REVIEW QUESTIONS

1. Prepare a voucher check which is a negotiable instrument and evidence of the payment of a particular account or obligation.
2. What liability, if any, does a bank assume in paying a check to a holder who claims under a forged indorsement?
3. The maker of a promissory note sends the payee his check for the amount on the day of maturity. The payee has the check

certified at the bank, but before it is paid the bank fails. Is the maker relieved of liability on the note by such certification? Give reasons for your answer.

4. A bank certified a check that had been altered by changing the date, name of payee, and raising the amount, and the bank subsequently paid the same to the defendant. Thereafter, the bank sued the defendant for the amount thus paid. Can it recover? Or does its certification of the check amount to a warranty of the genuineness of the body of the check as to payee or amount? Explain.
5. Is a depositing and checking customer of a bank obliged to verify the balance shown by pass-book and vouchers?
6. A retailer received a check for some goods. Before delivering them he telephoned the bank, and was told that the check was good. When he presented it for payment several hours later he found that other checks had been presented in the interval, and that the bank refused to honor his on the ground of insufficient funds in the depositor's account. Could the retailer rely on the telephoned approval of the bank as a certification?
7. How should a check be sent by mail for collection? May the holder of an uncertified check sue the bank? If a bank wrongfully dishonors a check, has the drawer any remedy?
8. What is the liability of the parties to a certified check? If a bank pays a check drawn on it by a depositor, after payment has been stopped, can the depositor recover the amount so paid?
9. In your state what is the statutory limitation to a bank's liability for payment of a forged or raised check after its return to a depositor? Liability of a bank for payment of a check after drawer's death?
10. Drawer of check has it certified, gives it to payee. Next day bank fails. Can payee collect from drawer?
11. On the morning of January 5, A gave B a check for \$100 on account. On the evening of January 7 the bank suspends payment. B has not yet presented the check. Is A's debt cancelled?

PART VI
INSURANCE

CHAPTER XXXVII

FIRE INSURANCE

§ 227. The Parties

Insurance is a contract by one or more parties to indemnify another for some loss which he may suffer in the future. If there is no loss, the agreement does not have to be carried out. The consideration is the premium paid. The written contract is called the policy.

Insurance is of various kinds. Fire, life, and marine insurance are the oldest forms of insurance. In addition, there have grown up accident insurance, burglary insurance, boiler, plate glass, and tornado insurance, credit, fidelity, title, and liability insurance, and other special forms of insurance too numerous to mention.

There are two parties to a contract of fire insurance, the insured and the insurer. The person whose property is insured is called the insured. The person or company who insures it is called the insurer.

The insurer may be a single individual, or a corporation, or an unincorporated company; or a group of individuals may get together and insure themselves. This last system of insurance is called mutual insurance. It is quite common in the country districts, where there may be a township mutual insurance. Whenever a fire occurs all the members of the fund are assessed proportionately to pay the loss.

In the non-mutual companies a fund is created by the payment of premiums, out of which the insurer pays for the losses which may occur.

§ 228. Nature of the Contract

The contract of fire insurance is a speculative one; that is to say, the event on the happening of which the payment is to be made, namely, the fire, may never happen. The person insuring the building must himself have some actual financial interest in the property insured, otherwise it would amount merely to a bet on his part as to whether the building would be destroyed by fire or not, and would be a gambling contract and illegal. Also if the insured had no interest in the building, and the building were destroyed by fire, it would be to his profit, and such an inducement might lead to crime.

Note:

1. The exact interest of the person insured in the property should always be made a part of the policy, to show that the contract is legal.

§ 229. Agents

Most insurance is taken out through agents. These may be of two kinds: those who are paid by the company and are the agents of the company, and those who act merely as brokers and solicit insurance for various companies. Agents acting for the company bind the company by their agreements if they have the power to close contracts of insurance. If the contract is required to be sent first to the company for its approval, any agreement of the agent will not bind the company. Sometimes, by means of a short written agreement called a binder, or even by an oral contract, an agent may bind his company for a certain limited or contingent period, as for instance, until the policy is made out or while the company is investigating the risk.

The laws of the various states are very strict with regard to insurance agents. In most of them an agent must receive a license from the state superintendent of insurance, or what-

ever officer exercises corresponding duties, in order to be permitted to act.

Notes:

1. In dealing with an insurance agent, always find out whether the company has to approve his agreements before relying on any changes he offers to make in the policy, etc. It is always safer to get the authorization of the company itself.
2. If you wish to act as an insurance agent, look up the law to see if you must take out a license.
3. If you deal through a broker instead of an agent of the insurance company, the broker is your agent.

§ 230. The Policy

Policies may be either open or valued. Most fire insurance policies are open. In an open policy the amount payable in case of loss is not fixed by the policy but merely the limit up to which the company will be liable. Then when a fire occurs the company pays the actual value of the loss up to the amount named in the policy. A valued policy, on the other hand, specifies the amount payable in the event of a total loss. Life insurance policies are valued.

It is a legal maxim that "to include is to exclude" and the insurance policy covers only what is stated therein. Some states allow oral agreements with, or representations made by, agents to be proved in order to alter the policy, but others do not. If it is desired to make other agreements not included in the policy form, they may be made in written form and made a part of the policy by referring to them in the policy.

Standard Forms of Policies. New York, Massachusetts, and some other states have a standard form of policy, which by law must be used by all insurance companies. Massachusetts adopted this form in 1881; New York in 1887. The Massachusetts form provides that a building must not be left

unoccupied for thirty days or the insurance will lapse. In New York it must not be left for over ten days. In addition, the New York form contains certain stipulations, including the following:

The company may replace or repair the property instead of paying the loss and may take damaged property by paying the full appraised value for it. It does not hold itself liable under certain circumstances, such as war or riot, usurped power, or destruction by order of civil or military authority; likewise it is released by the neglect of the insured to use all reasonable means to save his property when it is menaced by neighboring flames. It is not liable if the insured made any false representations or practiced any kind of fraud in procuring the contract. The policy does not cover such things as deeds, book accounts, and shares of stock, etc., which merely represent obligations to the insured, nor does it cover money. It does not cover a building after it or part of it has fallen from any cause other than fire. These provisions may not be altered.

If a building is left vacant for ten days, or a factory runs after ten o'clock at night or is shut down for more than ten consecutive days, the policy becomes of no effect, unless the policyholder shall have obtained a permit from the insurance company. This permit must be in proper form and must be attached to the policy. Any changes in the use or occupation of a building, or the installation of such things as electrical wires, gasoline stoves, etc., must be consented to by the company or the policy is void. In the absence of a provision to that effect, a policy is not nullified by the erection of neighboring buildings that increase the risk.

A common clause, known as "builder's risk" provides that mechanics such as gasfitters, plumbers, etc., may not be engaged to work upon a building without the consent of the company.

For the use or storage of inflammable or explosive substances, such as paint and gunpowder, in an insured building, a special permit is necessary.

The policy does not cover certain enumerated articles, such as jewelry, curios, office furniture, architects' plans, etc., unless they are expressly mentioned in the policy.

What the Policy Should Include. Every policy of fire insurance should include as full and accurate a description of the property covered as possible. It should also include the amount for which the insurance is taken out, the term for which the policy is to last, the rate of premiums and at what time payable, and any other conditions which the parties wish to make a part of the agreement. Personal property must be described as located at such and such a place; and if it is moved, a new policy must be taken out or the original policy extended to cover it, as the character of the building in which it is kept affects the risk very materially.

Cancellation. A fire insurance policy may be cancelled by either party upon five days' notice; a proportionate amount of the premium paid being returned to the insured when the company makes such cancellation.

Notes:

1. Everything you want included in the agreement should be put in writing and incorporated in the policy.
2. If the policy is a standard policy and the company's permission is obtained to make any changes in it, these should be in writing and made a part of the policy by a reference in it to the changes.

§ 231. Premiums

The premiums are the consideration the insured pays for the agreement to insure his property. They are based

on a certain percentage of the amount for which the property is insured and are payable periodically, generally either annually or semiannually. A failure to pay a premium when it is due causes the policy to lapse and be forfeited, but the company may consent to an extension of the time for its payment or may agree to take notes for the payment of premiums.

Note:

1. If an extension of time is procured for the payment of a premium, it is safest to have it in writing. Make your application for the extension by letter, retain copy, and enclose postage for a reply. The company's letter will be your protection.

§ 232. The Property Insured

The property insured may be either real or personal. A policy may cover both, as for instance a dwelling-house and furniture. A policy made out to cover "merchandise" or "household goods" will cover such as may be acquired later as well as those which the insured owns at the time of taking out the policy.

Insurable Interest. The party who insures a property must have what is known as an insurable interest in it. He may either own the property outright, or have some claim upon it, such as a lien or mortgage. The standard form of policy in New York provides that the insured must be the sole and absolute owner of the property, free from any claims of anyone else, but anyone who is not the sole and absolute owner may insure his interest with the company's consent.

If a mortgagee or trustee wishes to take out a policy, a clause must be inserted that the loss shall be payable "as his interest may appear." The company's consent must also be obtained to a chattel mortgage, or the policy will be void.

A man who insures another's property has an insurable interest therein and may protect himself by reinsuring it.

A man may have an insurable interest in property which he does not own at all. Thus a salaried agent whose employment is contingent upon the continued existence of a given property, may insure it. But the value of his indirect interest must somehow be determined and agreed to by the insurer and the insured. In like manner, a stockholder of a corporation has an interest, real though difficult to determine, in the property of the corporation.

Alienation. Any change in ownership or possession of property, including sale for taxes or under a lien, will make it necessary to assign immediately the policy to the new owner, unless he chooses to take out a new policy. Assignment must be with the consent of the insurance company and recorded on the company's books.

What May Be Insured. Any kind of tangible property may be insured. Deeds, bonds, shares of stock, book accounts, bank notes, promissory notes, and bills of exchange, etc., are not insurable. These merely represent an interest which the party has in some property and, if they are destroyed, the claim may be proved by witnesses without them. Money may not be insured; the United States Treasury will redeem what remains of it.

What May Be Insured Against. A fire insurance policy insures for damages other than those caused by actual flames. Injury due to the heat of a fire in an adjoining building would be recompensed, as would also damage caused by the means used to extinguish a fire, or damage caused by removing the goods to a place of safety even though it later developed that such moving need not have been done. To insure against damage by lightning where there was no actual ignition, a special lightning clause must be attached to the policy.

Floating Stock. A merchant may insure his stock with the understanding that it is to be replaced by other material of the

same kind. His policy would be known as a floating one, and in case of damage, he may recover on the stock on hand when the fire occurred, regardless of what stock was on hand when the policy was issued.

Coinsurance. A coinsurance clause stipulates that, in return for a reduced rate, the insured must insure his property up to a certain percentage of its value, usually 80 per cent, and if he fails in so doing he must himself bear a proportion of any loss, thus making him a coinsurer with the company of his own property.

For instance, if his property were worth \$10,000, an 80 per cent coinsurance clause would obligate him to carry insurance to the amount of \$8,000. If he carried only \$6,000 and a loss occurred, he would be paid only such a proportion of his loss as the insurance he carried bore to the amount he agreed to carry, in this case three-fourths. Therefore, if fire damaged his property to the extent of \$4,000, he would receive only three-fourths of this amount, or \$3,000.

Reinsurance. For the better distribution of risks, a company after writing a policy often insures itself for the whole or a part of the risk it has just insured. If then, the original insurer has to pay, the reinsurer is liable to the insurer for the amount paid, or for the proportionate part of it, as may have been agreed. The insurer may not reinsure for more than the original policy. The amount to be paid by the reinsurer is the amount the insurer has to pay, or a part of it, with one exception. If the reinsurer pays the claim of the insurer before the claim of the insured is settled, then it does not matter to the reinsurer what terms the insurer makes with the insured. If the insurer becomes insolvent, makes a final settlement and is discharged, he will receive from his reinsurer only what he paid. But when the insured has been paid off, then the other creditors can have no claim on what is due the insurer from the reinsurer unless the reinsurance has been

taken into account in making the calculations of dividends under which the insured was paid.

Notes:

1. In changing the location of personal property always be sure to take out a new policy.
2. In buying buildings of any kind, the first thing to do is to arrange for their insurance.
3. A person living in a house for which he is paying by instalments has an insurable interest in it.

§ 233. Warranties and False Representations

False representations are misstatements made to the company and its agents when applying for the policy, or afterwards as to any change in the condition of the property of which the company has a right to know. If such misstatements materially affect the policy they will render it void.

Concealment is the suppression of any material facts which the insurer does not know or is not presumed to know. Such suppression may be of the fact at the time application is made or of some later change in the condition which the insurer ought to know.

Any fact is material that might properly influence the insurer in taking or refusing the risk or that would affect the amount of the premium charged.

Warranties are representations which are included in the policy. They may consist in answers to a schedule of questions which are attached to the policy and made a part of it. If any of the warranties are false the policy is of no value. Even an inaccurate statement made through an honest mistake, if it is made a part of the policy, renders it useless.

Other Insurance. Misstatements as to other insurance where the policy is of the standard form will render it of no effect whether they are warranties or mere representations.

Increasing the insurance on the property increases the temptation to be careless or to have "accidental" fires, and the law is strict that the company must know of and consent to insurance on the property in any other company. Where a property is covered by policies in different companies, any one insurer is liable only for the proportion of the loss that his policy bears to the total amount of insurance.

Notes:

1. Be very careful to make only the most accurate statements in answer to any schedule of questions to be filled out in making application for the policy. If these statements are wrong, and the schedule is attached to and made a part of the policy, your policy may be of no value.
2. To conceal matters material to the risk may avoid the policy.

§ 234. Settlement of Losses

When a loss occurs the insured must at once notify the company and then make out an inventory of the damaged property, stating the value of each article separately. This inventory must be sworn to. The New York standard policy gives the company the option to require that it be confirmed by the certificate of a magistrate or of a notary public. In this inventory the insured must state if there are any other claims against the property; or, if it is partly owned by others, who they are and what is their interest in it, and what, to the best of his knowledge, was the cause of the fire.

The company usually sends out an adjuster to investigate the loss. He must be shown all the damaged property and any papers relating to its value, or plans, specifications, etc., which would aid in determining the value of the property destroyed. The insured must be ready to submit to any ex-

aminations which the company may wish to make and to make any relevant affidavits it may require.

If the insured and the company cannot agree on the amount necessary to cover the loss, the company and the insured each appoint one appraiser and the two go over the property and value it. They select an umpire who decides between them in case there is any dispute as to the proper valuation. Their decision settles the amount which the company is liable to pay.

A mortgagee has the right to recover from the insurance company whatever is due him under the mortgage at the time of the damage, provided of course the face of the policy covers the amount due and that the policy bears the customary mortgagee clause. This right, however, does not run with the land. That is, if the mortgagor sells the property subject to the mortgage, the buyer, who assumes the mortgage, may insure it without the mortgagee's having any interest in the policy. But if the buyer insures it, making the loss payable to the mortgagee, he may not revoke or cancel the insurance without the mortgagee's consent. In the same way, if a policy taken out by the owner, is made payable to the mortgagee as his interest may appear, his rights cannot be destroyed by any act of the owner. If the owner assumes to accept a settlement of a claim without the mortgagee's consent, he will not be bound by it.

Options Which the Company May Exercise. Under the standard policy in New York, the company has the right to replace or repair the property instead of paying for the loss. Or it may take the property on paying the appraised value for it. If the property is capable of being repaired, the company pays only the amount which is adjudged necessary to restore it to its former condition.

If the insured has any claims against persons other than the company for the value of the property, he must transfer them to the company when he is paid the amount adjudged

proper to cover the loss, and the company may sue and collect on the other claims.

Notes:

1. It is wiser to leave property in its damaged condition after a fire until the adjuster arrives. But if there is danger of its becoming more damaged by being left, it should be removed to a place of safety. The insured should take every precaution to keep the loss as low as possible.
2. Be sure to include everything in the inventory and to state its full value. It will be very difficult to prove any greater value afterwards.

REVIEW QUESTIONS

1. What is a contract of insurance?
2. Why must the person insuring have an interest in the property insured? Has a mortgagee an insurable interest?
3. What is the difference between an insurance broker and an insurance agent?
4. What is the distinction between an open and a valued policy?
5. What occurrences may invalidate a policy?
6. What phrase is used if a mortgagee insures property? What will be the extent of the mortgagee's recovery if the mortgage had been reduced before the fire occurred?
7. A notice of the premium due is sent to the insured with no mention of a penalty for failure to pay. Does policy lapse if payment is tendered one month late and refused by the company?
8. What is the meaning of an 80 per cent clause in a fire insurance contract or policy, and what would be the cash settlement by the insurance company in case the property insured inventoried at the time of the fire \$150,000 but was insured for only \$100,000? What would be the settlement if the property insured inventoried only \$75,000 but was insured for \$100,000?

9. What representations are material? What is a concealment and when must it take place in order to avoid the policy?
10. An insurance company fails, and can pay but 6 per cent of its liabilities. Some of its risks are reinsured. Is the solvent reinsurer liable for the whole amount insured by it, or only for the amount which the bankrupt insurer pays? Answer fully and give reasons.

CHAPTER XXXVIII

LIFE INSURANCE

§ 235. Nature of Contract

Life insurance today is one of the most important businesses in the country. Before the invention of the mortality tables the rates were high and the business was on too uncertain a basis to be widely utilized. With its present development it has become of the greatest value as a means of saving, investing, and protecting business. Its value as a protection against a dependent old age has caused governments throughout the world to become interested in it, different forms of old-age insurance being in use in various countries and among the state employees of Massachusetts.

This form of insurance has been under discussion for the past few years by the various state legislatures and commissions appointed for that purpose, but aside from Massachusetts has not actually come into being. The main objection, of course, to such insurance is that it will raise the taxes, and legislatures do not feel that the need is great enough to justify the increase of taxes at the present time.

§ 236. Insurable Interest

Like the contract of fire insurance, the contract of life insurance is a speculative one. If a person attempts to insure the life of someone other than himself, he must have an insurable interest in it, though this interest need not continue during the life of the insured nor exist at his death. One may, however, insure one's own life and make such insurance payable to a beneficiary who has no insurable interest in one's life.

An insurable interest in a human life is not easy to define. Generally the party who does the insuring must be related to the insured by such ties of blood, marriage, or contract that the death of the insured would materially injure him. A married couple have an insurable interest in each other's lives; a father has an insurable interest in the lives of his children because they might some day support him; a sister may insure her brother for similar reasons; a partner may insure the life of his copartner; or a creditor may likewise insure the life of a debtor.

§ 237. The Parties

The parties to a life insurance policy are: the person whose life is insured, or the applicant; the person for whose benefit it is insured, or the beneficiary; and the person or company insuring it.

Life insurance may be conducted either through a corporation, or through a fraternal organization, or it may be mutual. Many of the large life insurance companies are either mutualized, or are mutualizing. In a mutualized life insurance company, all excess over actual cost of insuring is later returned to the policyholders as dividends. In a stock corporation, this excess goes to the stockholders. Where a former stock company becomes mutualized, provisions are usually made by which the stockholders and policyholders are each to have a share in the dividends in proportion to what is determined to be their actual interest in the company.

Fraternal benefit insurance exists among the various masonic and other orders and in many business organizations. It is a form of mutual life insurance. When a benefit falls due, it is raised by assessment on the members in proportion to their rights to benefit by the fund, or else a fund is raised by assessment and kept on hand to meet the benefits as they become due.

§ 238. The Policy

Policies are of various forms. In participation policies, the accumulated surplus in any year is divided among the policies and the share of each is credited to it, to be paid over when the policy becomes due.

In non-forfeitable or incontestable policies, the company agrees that after a certain period of time the policy shall not be forfeited for any cause except non-payment of premiums. Courts will usually enforce this agreement. Of course, if the beneficiary has no insurable interest, the contract would have been illegal from the first and could not be enforced.

Policies may be whole life, that is, the premiums continue to be payable until the death of the person whose life is insured. If the policy is a participating one, the dividends may either be applied to reduction of the premiums, or may be accumulated, as the holder prefers.

Another form of policy is limited payment life. The premiums on this class of policy are so divided as to be payable within a limited number of years. After this the policy becomes a paid-up policy and is payable on the death of the person whose life was insured.

There are also endowment policies and term policies. The endowment policy is perhaps the most common form of policy. Under it, the amount is payable either at the end of a fixed term of years, or upon death in case of death before the expiration of that period. This policy operates both as an investment and a protection. At the end of the term the insured may, as a general rule, exercise his option to take out a paid-up policy and leave the money invested.

Term insurance is unlike endowment insurance in that it does not allow any accumulations, nor permit the holder to take out a paid-up policy at the end of the term. When the term has expired it simply lapses.

Term insurance is simply protection for a definite term at the lowest possible cost. Like fire insurance it covers the risk for the time specified and then ceases. It provides no accumulations to offset advancing age, the insured must assume this burden, nor does it provide cash, loan, extended insurance or paid-up values.¹

Double indemnity policies were first offered about 1912. These policies provide that in case of death by accident, the beneficiary shall receive twice the face of the policy. At first this double payment was made only in case of death by accident on a common carrier, but the policies now being written provide for double indemnity in case of death by any accident. In addition, these policies now provide that in case of permanent disability, payment of premiums shall be waived and one-tenth the face of the policy will be paid each year, and at death the full face of the policy will be paid.

Application and Examination. If the company does not consider the life a good risk, it has a right to reject the application. The applicant is required to answer questions on an application blank and to submit to a medical examination. As the application blank is made a part of the policy, any statements on it amount to warranties, and the policy will be of no value if any of them are false. If, otherwise than on the blank, the insured makes any false representations which have any effect on the risk or the insurance, the policy is void.

Notes:

1. A policy of life insurance should always be carefully read to make sure that the kind asked for has been issued. It is well to examine closely various forms and find out the advantages they offer before insuring. The laws of some states give more security to the insured than the laws of others.
2. Fraternal insurance has failed in many cases, be-

¹ Dunham on Insurance, I, 298.

cause new members ceased joining and those remaining could not pay the increased assessment.

3. To cheat the company by answering questions on an application blank falsely is useless. The policy will be worthless when the insurance is needed.

§ 239. Premium Rates

The premium rates in life insurance are worked out by means of the mortality tables. These are tables based on an examination of statistics, giving the probable length of life at certain ages. Accordingly a young person can take out insurance at a smaller premium rate than a middle-aged person. The rate increases as one grows older and death becomes more imminent.

If these premiums are not paid when they are due the policy becomes forfeited; but the company must give notice to the person whose life is insured, or to the assignee if the policy has been assigned, and notice to him again each time a premium becomes due. The company may extend the time of payment or take a note for the amount.

In fraternal insurance the members of the association are usually not charged premiums but are assessed on the basis of their interest in the common fund. Sometimes these assessments are made from time to time and a fund accumulated; more frequently they are made when some member dies and his family becomes entitled to the benefit.

Note:

1. It is much cheaper to take out insurance early in life.

§ 240. Agents

Life insurance agents, as well as fire insurance agents, must procure a license from the state department in charge of in-

surance. In New York these licenses have to be renewed every year. (See Part IV on the general subject of agency.)

§ 241. Right to Change Beneficiary

Unless there is a clause in the policy reserving the right to change the beneficiary, no change can be made without his consent in writing. The beneficiary has a vested right in the policy—one which he can himself transfer to someone else. In some states, even if he dies before the insured, the profits of the policy will go to the beneficiary's estate and no one else can be named.

The beneficiary cannot be changed without his consent if the insured has taken out the policy under an agreement with him, or if the beneficiary has paid any of the premiums.

The consent of the company must always be obtained to any change of beneficiary. This consent must be in writing.

Note:

1. The policy should always contain a clause permitting a change in the beneficiary. If such a change is not provided for, anyone taking the policy as security must get the written consent of the beneficiary to the arrangement.

§ 242. Assignment of Policy

A policy of life insurance belongs to the insured if he has taken it out and by its terms has the right to change the beneficiary, or to make his own estate the beneficiary. The beneficiary in such case has only a contingent interest, and has nothing he can assign to anyone else. If, however, under the terms of the policy the insured cannot change the beneficiary, then the beneficiary has a vested interest and he alone can assign it. The company must be notified of any assignment.

§ 243. Settlement of Losses

When he makes his claim for the proceeds of the policy, the beneficiary must send with it a proof of death filled out on one of the company's forms and certified by a physician.

Where there has been a change of beneficiaries or the policy has been used as security, there may be conflicting claims for the proceeds. If the various claimants can agree among themselves, the company will generally pay the loss to those who are admitted to be entitled to it, upon receiving releases from all the claimants. If there is a dispute which cannot be settled otherwise, it usually has to be decided in court.

The company will resist the payment of claims if there was any fraud in the procuring of the policy or if misrepresentations as to the health of the insured come to its knowledge. In one case known to the writer, the beneficiary in the proof of death made a statement as to the age of the insured person which differed from that made in the policy. The company discovered that there had been a misrepresentation and resisted the payment of the claim.

Suicide, unless committed within a year from the time the policy was taken out, does not generally excuse the company from payment. Many policies provide that if the insured is killed while engaged in the commission of crime or executed as a punishment for crime, the policy will not be payable. The death must be the result of the crime in order to render the policy void. Dying of apoplexy while attempting to hold up a train would not excuse payment.

Notes:

1. In order to make sure that the proceeds of a policy will go to the person whom the insured intends to benefit, without an expensive lawsuit, it is wisest, when making any change in a policy, to get a written release from any party who may be af-

fectured by the change, and keep it attached to the policy.

2. Under the New York law, creditors can collect all insurance over the amount a \$500 a year premium will bring.

§ 244. Government Insurance for Soldiers and Sailors

At the entrance of the United States into the Great War, the government announced, as a substitute for the pension system, a plan of insurance for officers and men of the army, navy and marine corps. Under this plan, the government undertook the costs of administration, and offered term insurance on the monthly income plan. (See § 238.)

The term extended from the beginning of the war to five years after the declaration of peace. By the monthly income plan is meant a system of paying the beneficiary, not a lump sum to be kept as capital, but a monthly sum to be used as income, payment to run in this case, for a period of twenty years. By this system a man taking out the maximum insurance of \$10,000 would pay approximately \$6.50 per month for it, the rate increasing slightly each year. In case of his death from any cause his beneficiary (who must be a relative) receives \$57.50 each month until 240 payments have been made).

Within about six months after the armistice was signed, the government announced a plan of converting any of these term policies into one of six forms more closely resembling ordinary commercial insurance. The new forms offered protection to ex-soldiers, sailors and marines for the remainder of their lives. Conversion may be made at any time within five years after peace has been declared; if not made at all, the insurance simply stops.

The six policies now offered holders of the original term insurance are:

1. Ordinary life
2. Twenty-payment life
3. Thirty-payment life
4. Twenty-year endowment
5. Thirty-year endowment
6. Endowment at age of sixty-two

In all cases except where the policyholder lives to draw the endowment himself, the benefit is paid on the monthly income plan, payments covering twenty years. A disability clause is attached to all these policies, whereby if the policyholder is totally and permanently disabled, the government waives premiums and pays him for the remainder of his life, the monthly income his beneficiary would have had. This deprives the beneficiary of any payments except where the insured dies before 240 payments are made to him. In such a case, the beneficiary receives a monthly income for the remainder of the twenty years.

All matters relating to this subject are controlled by the Bureau of War Risk Insurance, Washington, D. C. In case the Bureau gives an adverse decision on any claim, appeal may be taken to the federal courts.

REVIEW QUESTIONS

1. What is meant by an insurable interest in another person's life?
2. What are the three methods of life insurance? Explain each.
3. Explain the following classes of policies: Participation, non-forfeitable, whole life, limited payment life, endowment, and term.
4. One Williams had a life insurance policy in the American Life Insurance Company for \$10,000. The policy provided that if the annual premium was not paid on the day it became due the policy should become void. Williams became ill and failed to pay the premium on the day it was due, and about a week

afterwards his son wrote the office of the company in care of the president, and told him that his father was ill, and asked that the time be extended. The president wrote back that if he would pay the premiums within one week it would be all right. Williams died the following day, and before the week elapsed, the son came and tendered the premium, which the company declined to receive, and denied any liability on the policy. Is the company liable thereon? Give your reasons for your answer?

5. Can the beneficiary be changed?
6. When can the beneficiary assign his rights?
7. Why did the government arrange to insure its soldiers and sailors?
8. Into what forms was this converted at the close of the war?

CHAPTER XXXIX

SUNDRY INSURANCE CONTRACTS

§ 245. Enumeration

In addition to fire and life insurance, there are sundry other insurance contracts, such as marine, accident, health, group, liability, title, burglary, plate glass, automobile, boiler, burial, credit, fidelity, hail, live stock, rent, strike, and tornado.

In all of these the policies call for certain representations which must be truthful; and proofs of loss must be made out and, as a rule, sworn to, when payment of a loss is claimed.

§ 246. Marine Insurance

This is the oldest form of insurance, older than either fire or life insurance. It originated in Lloyd's Coffee House in London, and the policy is known as Lloyd's. The policies were passed around among the dealers in insurance, and each took such share of any given risk as he cared to. These subscribers were called underwriters and in case of loss they were assessed in proportion to their subscriptions to pay the loss. The business is handled by regular incorporated companies today. Its object is to protect the insured against losses on a vessel at sea. Marine policies may also be taken out on ships traveling in any navigable waters.

The policy covers losses by fire, various forms of shipwreck including losses incurred in trying to avert shipwreck, and losses from piracy. The insured is by custom held to be in duty bound to give the insurer all information in his power with regard to the ship, the voyage, the cargo, or anything else that might affect the risk. If he conceals anything or

makes any false representations, the policy will not take effect. The person taking out marine insurance must fulfil the following requirements:

1. He must have an insurable interest in the goods or vessel insured.
2. He must warrant that the vessel is seaworthy.
3. He must warrant that the goods insured were in good condition when taken on board.

If any of these conditions are not met, the insurer will not be liable.

In a marine policy, the amount payable in case of loss is fixed by the policy, and no attempt at valuation is made unless the loss is incomplete. Marine policies also cover what is known as general average.

Proofs of loss, giving full particulars of the nature, amount, and cause of the damage must be made out and sworn to by the master and crew of the vessel; and then an investigation is made either by some government surveyor of the port, or by experts chosen by the parties to the contract. In the event of a dispute as to the amount of the damage, the damaged goods are sold at auction and the amount determined in that way. The insured must show bills of lading or other documents to prove his ownership of damaged goods, and the policy cannot be assigned without the underwriter's consent.

In the American Lloyd's policies it is provided that if there is any prior insurance on the vessel the underwriters shall be liable only to the extent that the prior policies do not cover the loss.

§ 247. General and Particular Average

From the earliest times, it has been the custom, where goods were jettisoned (i.e., thrown overboard at sea to save the vessel), for the other owners of merchandise on board and

the owners of the vessel to contribute proportionately to make good the loss. This is called "general average." In calculating the assessment the owner of the lost goods is included; it follows that he is never reimbursed by general average for his full loss. The assessment is a lien against the goods until the entire amount is paid. The underwriter takes upon himself the responsibility of collecting this contribution.

The term "particular average" is applied to the payment for partial loss. This refers to actual insurance on the particular thing or goods insured and is paid by an insurance company. The clause reads generally to this effect: "no partial loss or particular average shall in any case be paid, unless amounting to 5 per cent." Then if less than 5 per cent of the goods is completely lost, no claim at all can be made against the insurance company; or if the whole cargo is damaged to a slight extent, no claim can be made. The term to indicate that a policy does not cover partial losses, is "free of particular average," often abbreviated to F. P. A. The opposite term, indicating more complete insurance at a higher rate, is "with average" (W. A.) or "against all risks" (A. A. R.)

Note:

1. Anyone taking out a marine policy should be careful to note just what dangers it protects against, especially what provision it makes in case of war. In the Lloyd's policy it is necessary to make a special arrangement, as the ordinary policy expressly releases the insurer from damages arising from the perils of war.

§ 248. Accident Insurance

Accident insurance is insurance against injury or death by accident. The policy may cover injury only, or it may also provide for a payment to a beneficiary in case of the death of

the insured by any accident. The proceeds are payable to the person himself in case of injury. These policies do not cover mere illness, but such things as ivy poisoning, etc., which are regarded as accidents, are included.

Sometimes there is a dispute as to what constitutes an accidental injury. Thus, although infected water might be drunk through accident and serious illness result, one could not collect an indemnity; whereas one could collect on injuries due to inhaling gas, poison taken by mistake, etc.

Many companies will not pay if the insured exposed himself to unnecessary risk such as jumping on a moving street-car; nor will they pay for injuries received while intoxicated, though in this regard there is sometimes great difficulty in deciding if a person's intoxication were such as to make him more liable to injury, and if it were not they would have to pay.

All accident policies provide lump-sum indemnities for such injuries as the loss of a hand, etc.

§ 249. Health Insurance

Some companies insure against sickness and ill health. Usually these policies name a list of diseases in event of which a weekly indemnity is granted. In some cases the health insurance is allowed only in conjunction with accident insurance. Some of the fraternal orders allow their members sick benefits which are the equivalent of health insurance. Practical difficulties in administering the business of insuring against sickness have limited its development. A savings account is probably the best provision against ill health.

§ 250. Group Insurance

Group insurance is a plan to insure a number of the employees of one employer offering an eligible group, without individual medical examination, under one blanket contract

issued to the employer. It is generally applied only to life insurance though the principle of insuring a group could logically be applied to accident and health insurance at least.

The premiums for this insurance are paid monthly by the employer and the insurance is payable to the beneficiary named by the employee. Ordinarily the basis of insurance is one year's salary with a maximum of \$3,000 to any individual. Any employee receiving annual remuneration in excess of that sum would receive only \$3,000 insurance.

If it is desired by the employer, the insurance company will settle the insurance benefits in twelve monthly payments. This would amount to a continuance of the pay check for a full year in the event of death while in service—during which time the beneficiaries would be able to adjust themselves to the changed conditions caused by the death of the breadwinner.

The operation of the plan is simple. New incoming employees are automatically included upon passing a simple health test and the insurance by the employer on outgoing employees ceases upon termination of service.

The cost depends on the age and annual wage of each employee. It would be approximately $1\frac{1}{4}$ per cent to $1\frac{1}{2}$ per cent of the annual pay-roll.

§ 251. Liability Insurance

Liability insurance is to protect the employer from liabilities arising under the Employers' Liability or Workmen's Compensation Acts. (See §§ 279, 280.) In many states it is possible to take out this form of insurance with a state fund. There is also automobile liability insurance, which covers liability for injuries to others resulting from the use of the automobile. Railroad companies may take out insurance (carriers' liability insurance) to protect them against liability to passengers and others, for injuries arising from railroad accidents.

§ 252. Title Insurance

In order to protect purchasers of real estate against the expense of lawsuits arising from possible defects in the title to the property, a business of investigating and insuring the title has grown up. Title insurance companies generally furnish both title searches and insurance. As with most other insurance of this nature, the company generally settles the claim or defends the suit on notice from the insured that he has been served with a notice of suit.

§ 253. Burglary Insurance

This is one form of what is known as casualty insurance, that is, insurance against accidents to property of various kinds other than loss by fire. It is, as the name implies, insurance against loss of property by theft. It applies only when the theft is committed by someone breaking into the house or building where the property is kept, unless the policy states otherwise. It would not cover having one's pocket picked.

§ 254. Plate Glass Insurance

This is insurance on large plate glass windows because of the great expense of replacing them. It also is a form of casualty insurance. Where the windows are injured in a fire, if there is any insurance other than the glass insurance policy on them or on the building, only an amount proportioned to the relation of that policy to the whole amount of insurance on the building can be collected on the plate glass insurance policy.

§ 255. Automobile Insurance

Many companies offer automobile insurance. What is known as a full cover on an automobile includes insurance against the hazards of:

1. Fire or explosion.
2. Transportation, i.e., derailment and collision.
3. Theft.
4. Damage by fire to personal effects carried upon the car.
5. Damage to other property by being in collision with the automobile insured—known as property damage.
6. Damage to the automobile insured by being in collision with some other object.
7. Loss of life or injury to the occupants of the car and legal liability for expenses in connection therewith.
8. Loss of life or injury to others and legal liability for expenses in connection therewith.

The rates are high to compensate for the very considerable risks. What is known as the "moral hazard," i.e., the risk of unfair dealing by owners, is great, and hard to guard against. The enumeration of hazards shows the varied possibilities of loss and damage.

§ 256. Other Forms of Insurance

Boiler Insurance. This is insurance against injuries to property arising from boiler explosions, another form of casualty insurance. A fire insurance policy does not cover such a loss unless the explosion resulted from a fire.

Burial Insurance. This form of insurance is in operation among the very poor. In return for certain weekly or monthly payments, the company guarantees to pay the expenses of a decent burial.

Credit Insurance. Credit insurance is insurance against the dishonesty or the insolvency of debtors.

Fidelity Insurance. Fidelity insurance is insurance against losses arising from fraud or dishonesty on the part of agents or employees. There are three forms of fidelity bonds: first,

the larceny or embezzlement bond; second, the culpable negligence bond; and third, the faithful performance bond. The last is the most comprehensive and the most costly.

Hail Insurance. This is common in the grain states, where the farmers often suffer heavy loss because of the damage hailstorms do their crops.

Live Stock Insurance. Blooded animals are so valuable that their owners find it necessary to protect themselves against loss by carrying insurance against disease or death.

Rent Insurance. This is insurance for the loss of rents owing to the failure of tenants to pay rent, or to a destruction of the property by fire or some other calamity.

Strike Insurance. An employer can even insure himself against strikes on the part of his employees, and the consequent losses.

Tornado Insurance. As its name indicates, this is insurance against damages and loss of property arising from tornadoes.

REVIEW QUESTIONS

1. What three requirements are essential to the contract of marine insurance?
2. Has a stockholder an insurable interest in a steamboat owned but not insured by the corporation?
3. What is "general average"?
4. What is "particular average"?
5. What risks are usually covered by an accident insurance policy?
6. What is group insurance?
7. What is the usual purpose of liability insurance? Who takes out the policy?
8. What is title insurance?
9. What does the owner of an automobile want insurance against?
10. Who takes out fidelity insurance? What is the simplest form? Under this form could the holder of the policy recover if his employee lost the money?

PART VII
EMPLOYMENT

CHAPTER XL

THE CONTRACT OF EMPLOYMENT¹

§ 257. Introduction

The contract of employment is perhaps the one which most concerns the ordinary man in his every-day affairs. All the relations between employers and employees are governed by contract and the laws regulating the subject. In recent years, these laws have undergone almost a revolution; and they are still being rapidly changed to meet the modern ideas of what such relationships should be, and the new sense of the obligations which the employer owes to those under him. It is most important for everyone to know exactly what these changes in the law are, and how they may affect him individually.

The Federal Employers' Liability Act, which defines the rights of all employees engaged in the business of interstate commerce, has been followed in many of the states by acts of like tenor; and various efforts have been made to introduce some of the schemes for workmen's compensation and old-age pensions from abroad. Both of these plans have already been adopted in some of the states; and, it would appear from the trend of modern legislation, they are likely in the near future to be enacted into some form of law in most states of the Union.

Too much importance cannot therefore be given to the contents of this particular chapter. For this reason the subject of the relations of employer and employee has been treated with some fulness of detail.

¹ For forms of contract of employment, see Chapter CIV, Forms 46, 49.

§ 258. Definition

A contract of employment is a contract for the performance of services, by the terms of which the employer is to direct how the work is to be done and what results are to be accomplished. This personal direction by the employer is the essential feature. A contract with a tailor for a suit of clothes is not a contract of employment because it lacks the element of personal supervision.

In the older law books the subject of this part of the book was treated under the head of "Master and Servant." It is far from modern habits of thought and speech to consider a member of a labor union or the auditor of a corporation as a servant. Hence, the obsolete terms are not used in this work.

§ 259. What Constitutes a Contract of Employment

There must be an agreement by competent parties. One party agrees to perform services for the other. There must be a consideration. One party gives his services in return for the payment of wages or salary by the other party. The contract may be expressed or implied. If a man does any work for another on request, the law will usually imply a contract to pay a reasonable compensation. If services are rendered for another with his knowledge and acquiescence, a contract is usually implied.

A contract to do work on shares is an agreement by one party to perform some labor, such as raising a crop, for a share in the crop. For instance, a man may agree to cut grass for a land owner for half the grass. Such contracts are common in farming communities. The fact that the wages are paid otherwise than in money does not alter the relationship.

As has been stated (§ 258), the peculiar and distinguishing element of the contract of employment is that the party for whom the services are to be performed has the right to direct

the other party in what he is to do. A contract to build a house where the builder merely agrees to construct a house according to certain plans to be furnished by an architect and to the satisfaction of the person for whom he is building it, is not a contract of employment. But where a man agrees to do the manual work of building the house under another's orders as to how it shall be done, he is that other man's employee.

The essential element of the relation of employer and employee is the right of the employer to give orders to and direct the employee in the performance of his work.

Most of the work on public buildings, roads, canals, etc., is done by letting the entire contract to a contractor who in turn lets out parts of it to subcontractors. The question of the liability of the main contractor to the employees of his subcontractors rests on this principle. If the employees are taking orders from his foremen, the chief contractor is liable to them as he would be to his own employees (see § 271). If the subcontractors are to do their own directing and give the orders to their own men, being responsible to the main contractor only for the finished results of the work, then he is not liable to their workmen any more than he would be to outsiders.

§ 260. Independent Contractors

Independent contractors are not employees. An independent contractor is a man who engages with another to hand over to him in completed form some particular piece of work, and to receive a certain sum of money for doing it. In building, the excavating, the mason work, the plumbing, and the painting are usually undertaken by such independent contractors.

Where a contractor merely engages to do a piece of work for another and retains the right to direct its doing himself through his own foremen, his employees do not ordinarily stand in the relation of employees to the person with whom he

has contracted. Sometimes, however, the law says they shall have the rights of employees, and then they may claim them. Most of the state enactments as to employers' liability and workmen's compensation give employees of independent contractors the same rights against the principal contractor that his own workmen have.

§ 261. Interpretation of Contract

The contract of employment is to be interpreted in the light of what both parties reasonably understood it to mean. The same rules that apply to contracts in general govern this type of contract. (See § 49.) In case the provisions are indefinite, the question as to when it will be understood to begin and to end is answered in §§ 265, 266.

Any well-recognized customs in the particular trade or business to which the contract under consideration relates, such as a custom of paying a certain percentage as commission to insurance agents, etc., will be considered in seeking to find the meaning of the contract.

§ 262. An Express Contract Cannot Be Proved by Custom

In attempting to prove an express contract of employment, it is not enough to show the usual custom of a mercantile house or other business in making such contracts. The house is entitled to make a separate contract with every employee; the duties and rights of each employee are regulated by that contract without regard to dealings with other employees.

For instance, in an Alabama case, an employee claimed that there was a custom in the firm to engage employees by the year, and that therefore his employment with them was for the year. The court said that he must prove the actual agreement between himself and the firm.³

³ *Hartsell v. Masterman*, 132 Ala. 275; 31 So. 616.

Sometimes provisions may be read into a contract from customs which are universally known in the line of business in which the contract of employment was made. For instance, if there was a universal custom to pay employees by the week, the court might find from the testimony that both parties had it in mind at the time of the making of the contract. In order to prove this to be the fact, however, the custom must be so universal that everybody in the business ought to know of it, and either party may prove that they expressly agreed otherwise.

Note:

- I. In making a contract, it is not safe to rely on custom. All provisions of the contract should be stated expressly.

§ 263. Wages

Wages are payable by the day, the week, or the month where the contract expressly provides that they shall be, or where it is the custom to pay in that way, so that the parties might be supposed to have intended to make it part of their agreement. If there were no such custom and the contract said nothing about it, the employee would not be entitled to his wages until the end of the entire period for which the contract was to run.

The custom of paying wages at short periods, by the week or month for example, is pretty well established. If the parties desire to arrange otherwise, it should be so stated in the contract.

§ 264. Modification of Contract

The contract of employment, like every other contract, may be altered by the consent of all the parties to it. The question of whether there must be consideration or not, or what con-

stitutes consideration for the new contract, has already been taken up under the subject of contracts in general. (See § 44.)

§ 265. When Contract Begins

Where the contract does not state when it is to begin, it begins at once, or as soon as is reasonable under the circumstances. For instance, if a man is employed to act as book-keeper for a business which has not yet been started, he will not be expected to begin his work or draw his salary until the business starts.

Note:

1. Both parties should see that the time when the employment is to begin is made part of the contract.

§ 266. Termination of Contract

Where there is no definite time fixed for the contract to end, it will end when either party desires to terminate it. If a definite time is fixed for the payment of wages, such as a day, a week, or a month, the contract will last for at least that period of time, and cannot be terminated before. If the employment is by the week, month, or year, it cannot be terminated by either party except at the termination of such a period. If the employer discharges the employee (except for good cause) before the end of such a period, he will be liable for the employee's wages until the end of the period.

If the employee leaves in the period, he will, strictly, forfeit all claim for compensation. Some courts allow in such cases whatever value the employee can show for his services, less any damage caused by his leaving before his time was up.

Notes:

1. A definite understanding as to the duration of the employment is better for both employer and em-

ployee. It will avoid unpleasant disputes and may save a lawsuit.

2. Both employer and employee should act fairly about terminating the employment. To leave without notice at end of period or to discharge without notice at end of period is in most cases unfair.

§ 267. Termination of Contract by Breach

A contract of employment may end either when it is completed, or when it is broken by either of the parties to it.

What the Employee May Do. On the part of the employee, the contract may be broken either by leaving the employment or by doing something which would justify his employer in discharging him—by acts of disobedience or insubordination, or by acting contrary to his employer's interests.

The disobedience or insubordination must be such as will prevent the employer from being able to rely on the employee to do good work. And the employee is under no obligation to obey an order to do anything not called for by his contract. A department store owner discharged the head of his dress-making department because she refused to obey his orders to perform the work of a seamstress. The court held the discharge a breach of contract.

Either incompetence or habitual drunkenness constitutes a breach of the contract. The employee undertakes to be only reasonably competent, however, and he cannot be discharged for not being an expert, unless there is some express understanding calling for a specified degree of skill.

An illness of the employee which keeps him from work also puts an end to the contract, though it may hardly be regarded as a breach.

What the Employer May Do. The employer may break the contract either by discharging the employee without justification, or by rendering the work in some way unsafe to his

health, his life, or his morals. Or he may break it by requiring the employee to work for less wages than were agreed upon, or to perform different services. He can make none of these requirements without the employee's consent.

A contract of employment is one involving personal relations and cannot be assigned by either of the contracting parties. Therefore, if the employer sells out his business to other parties, his employees cannot be compelled to work for the new owner. If the employer takes a partner and forms a new firm, or if a firm becomes incorporated, the result, so far as the employees are concerned, is similar to assignment of the contract to a third party.

The bankruptcy or insolvency of the employer or the winding up of his affairs by a public officer, as in the case of a bank or an insurance company in danger of insolvency, puts an end to the contract.

The fact that an employer has no work for an employee will not justify a discharge before the end of the contract.

Notes:

1. In selling out a business, or changing the nature of a business, an announcement of the new arrangement should always be made to the employees.
2. Remaining in the employment with knowledge of the change amounts to an acceptance of the new arrangement.

§ 268. Rights and Remedies

In any case, except where the employee has been guilty of actual disloyalty to his employer by engaging in competition with him, or has offered physical violence to his employer, he is entitled to the wages, salary, or commissions which he has already earned, and, if a bonus has been declared, he is entitled to that too. This is true whether the

breach of the contract is due to his own action or to that of his employer. (See also § 273.)

Employee's Rights to Damages. Where the employer is guilty of a breach of the contract, the employee is entitled to damages. He may sue at once and collect what is already due him, or he may wait until the contract period is over and then sue for the total damages he has sustained. It is his duty to try to obtain other employment, and the damages which he may recover are limited to the difference between the wages he would have received and any sums which he has been able to earn since.

Where the wages or salary are to be paid at stated periods, the courts in some states allow the employee to sue at the end of each period for the amount then due him; as for instance, where the wages are payable by the month, at the end of each month. In other states the employee may bring only one action, and if he sues before the end of the contract period he may recover only such damages as he has suffered up to that time, and will have no further remedy.

Where a contract of employment provides for notice on both sides, the employer must give the required notice or pay the employee wages for the period of notice before discharging him; and if he fails to do this the employee is entitled to recover this amount as damages.

Employer's Grounds for Damages. If the employee breaks the contract, the employer is entitled to recover any damages he can prove. He must prove that it is impossible for him to procure anyone to do the work in the employee's place. He cannot recover any damages if the employee leaves his employment because of illness. He will be entitled to retain wages equal to the amount of notice the employee is required to give, only in case there was such a provision in the contract.

Interfering Between an Employer and Employee. If a third person, knowing that a workman is employed by another

and that the term of his employment is not over, induces an employee to leave his employer before the contract of employment has expired, the third person is responsible to the employer in damages should he have acted with full knowledge of the circumstances.

If a third person induces an employee to make a contract with him after the time of his contract with his employer is up, the employer has no cause of action. Or, if the employee has broken the contract himself and then obtains employment from a third person, the employer has no rights against the third person.

If a third person succeeds in getting an employer to discharge an employee, the employee has a right of action against that person. But if the third person merely attempts to influence the employer and is unsuccessful, the employee has no ground for action.

References. The employee has no legal right to a reference. But nowadays the custom of giving references has become in some places so universal that it almost amounts to an understood part of the contract.

Note:

1. Contracts providing for notice should specify a definite time and a definite amount of wages to be forfeited on the part of the employee for failure to give notice.

§ 269. Employment After Expiration of Contract

Where the contract sets a definite time for its termination, and the employee continues in the employment after that time without any new understanding, the general rule is that, if the work which he is doing is the same, he is supposed to have been employed on the same terms.

The new contract in such case will be for the same time

as the old. For instance, if a workman hired for a year remains in his employment into the second year without any new agreement, it will be presumed that he was working under an agreement for another year; and it will be a breach of the contract, for which the employer will be liable in damages, if he discharges the workman before the end of this time. The employer, however, may, if he can, show facts to prove that there was no such understanding.

Note:

1. In this case again, it is safer to have a definite understanding about any renewal of the contract.
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REVIEW QUESTIONS

1. What is the distinction between an employee and an agent?
2. Is a salesman working on commission an employee?
3. What is an independent contractor?
4. When an employee is working by the week or month and leaves without cause during the period, what are his legal rights in your state?
5. What causes would justify the discharge of an employee? In such cases would the employee be entitled to compensation up to the time of discharge?
6. What causes would justify an employee in leaving before the expiration of his period of employment?
7. In what ways in your state may an employee seek redress for an employer's breach of contract for a fixed salary payable at regular intervals?

CHAPTER XLI

RELATIONS OF PARTIES

§ 270. Duties of Employee to Employer

The employee by entering into the contract of employment represents himself to be reasonably competent for his work. If the work is manual labor, he is not required to have any experience and must be given a reasonable time to learn its duties. Where the work requires skilled labor, such as in handling machinery, etc., the employee is required to be reasonably and ordinarily competent. If any high degree of skill is required, it must be stipulated in the contract.

A case is on record where a baseball club engaged a pitcher without any definite requirements expressed in the contract; and when they tried to discharge him because he did not come up to what they expected of him, the court made them pay damages, because it could not be proved that he could not pitch as well as the average professional player.¹

There may be a provision in the contract that the employee must be satisfactory to the employer. In most states even then the employer will have to show good reasons for his dissatisfaction before he may discharge his employee.

The courts will not compel an employee to work if he refuses. If the employer can prove that he has suffered by the breach of the contract, the employee is liable to the employer in damages, but there is no way of forcing an unwilling employee to work.

The employee must perform the services stipulated in the

¹ *Baltimore Baseball Club v. Pickett*, 78 Md. 377; 28 Atl. 279; 44 Am. St. Rep. 304; 22 L. R. A. 690.

contract. It is not his fault, however, if their value to the employer is destroyed by the act of some third person, and the employer is none the less bound to pay him the wages agreed upon for them. For instance, in a certain Alabama case one Parham employed a man named Tucker to go into Mississippi and get back some slaves for him. Tucker got them back and they were immediately attached by a creditor. Tucker had nevertheless fulfilled his contract.²

Loyalty and Obedience. Other duties which the employee owes his employer are those of loyalty and obedience. He must not do anything which may injure his employer's business, and has no right to engage in any employment which is in competition with it. Otherwise, the employee has a right to use his spare time as he likes, unless he has agreed by the contract to devote his entire time and attention to the business.

Sometimes, even in such a case, it has been held that the employee has a right to do something else which does not injure his employer where the employer fails to furnish him with work. In the California case of *Stone v. Bancroft*,³ Stone, a publisher who had been employed by Bancroft to devote his entire time to publishing the historian's works, did some work on a medical book while he was waiting for Bancroft to furnish him the manuscript. The court held that Bancroft could not complain, since he had given no work to the publisher. Bancroft was, of course, liable to pay him at the contract rate for the entire period of the engagement.

Part of the employee's duty of fidelity to his employer consists in keeping to himself any business matters of a confidential nature. If an employee discloses any secret processes—what are known as "trade secrets"—he is liable to his employer for damages.

Law clerks and lawyers' stenographers are privileged from

² *Wolfe v. Parham*, 18 Ala. 441.

³ 139 Cal. 78 Pac. 1017; 72 Pac. 717.

testifying on the witness stand to any confidential communications from clients. This privilege does not extend to ordinary stenographers, bookkeepers, or clerks on the witness stand.

Liability of Employer in Using Force. The duty of obedience cannot be enforced by the use of violence on the part of the employer. Formerly a master was allowed to chastise his apprentice on the ground that he stood *in loco parentis* (in the place of a parent) to him. But there is no justification for an employer laying his hands on his employee nowadays, and he would be liable to an action for assault and battery if he did so.

Inventions. The patent rights to inventions which the employee makes in the course of his work belong to him and not to his employer, but it is probable that he would have to give the employer a right to make use of the inventions. It is common nowadays for employers to make some provision in the contract of employment for taking over inventions made by their employees.

Notes:

1. If the employer wishes anything more than ordinary skill from his employee, he must include the requirement in the contract.
2. If the employer wishes to make any arrangement about inventions, he should come to an agreement with his employee and have that included in the contract.

§ 271. Duties of Employer to Employee

The employer owes it to his employees to provide a safe, healthful, and suitable place to work in, and proper tools to work with. To do this, he must arrange for suitable inspection to see that things are in the proper condition and remain so. And it is his duty to hire competent fellow-employees.

An employee is not required to expose himself to the danger of working with drunken, reckless, or incompetent associates.

Responsibility of Employer. These duties of the employer cannot be shirked. He is always responsible for failure to perform them, no matter whom he appoints to attend to them. He must keep buildings, etc., in proper repair, examine machinery to see that there are no dangerous defects in it, and inspect everything that comes to him from any other person to see that it is in safe condition before giving it to his employees to work with.

Co-operation of Employees with Employers. The law is reasonable. The employer is not responsible for an injury arising from an unknown defect, if he has used reasonable and proper inspection. He cannot be required to be continually inspecting; therefore it is the duty of employees to inform the employer of any defects which they notice. If they do not, and suffer injuries, they must usually take the consequences; but at the same time the employer is in a better position to be aware of defects than the employee, and where the defect is a hidden one, it is the employer's and not the employee's business to discover it.

It might be well to state that there are many regulations (hours, sanitation, etc.) which the statutes of each state require, and that often it is required to post a copy of the law on the walls of store or factory. (See also §§ 279, 280, on employers' liability and workmen's compensation acts.)

Limits of Liability. The employer will not be liable for the consequences of defects which nobody could have foreseen and prevented, such as the flying off of slivers of steel from crystallization, a defect which cannot be discovered without a chemical test and the breaking up of the steel in order to perform it. And he is not obliged to employ experts specially to make chemical and other scientific tests. He is required

to make only the ordinary tests employed by those engaged in that occupation.

If an employee is competent when hired and afterwards becomes reckless, drunken, or incompetent, and his acts take place without the knowledge of the foremen or superintendents, though these exercise reasonable supervision, the employer cannot be made liable for the consequences of such acts.

Provision for Work. The employer must provide enough tools and employees to perform the work with safety to all. And he must make proper rules for the conduct of the work and see that they are carried out. Where the law requires safety appliances, seats for women, etc., the employer must comply with it; but in the absence of any statute on the subject he is not required to use the latest and best appliances if those which he has are such as are in ordinary use and are reasonably safe.

Instruction of Employees. It is his duty to instruct young and inexperienced employees in the proper way to make use of tools and machinery, and to warn them of any dangers. He is not responsible if his employees disobey his orders and are injured in consequence; but if their disobedience has been going on for some time, so that it ought to have been known to the foremen and others in charge if they had been reasonably diligent in their duties, or if it has been going on with their knowledge and consent, the employer will be considered to have consented to it and will be responsible for resulting injuries as though the rules had never been made.

If he allows young and inexperienced employees to work in places which tempt them to take risks, it has been held that he will be responsible for any injuries they may suffer in consequence. A case illustrating this point was that of a young boy set to work turning a wheel near the log carriage in a saw mill. The court said that it was tempting him to

follow his natural instincts to ride up and down on the log carriage, and that the employer was responsible for injuries for putting him in such a place.⁴

Employees Must Take Reasonable Care. After the employer has seen to the furnishing of sufficient and proper tools and a safe place to work, he is not responsible if the workmen themselves misuse them. When unfinished appliances, such as molds furnished in two or more parts to be put together, or lumber furnished for making a scaffold, are given to the workmen to be put together, if the men do the work improperly the injuries are not the employer's fault. But a permanent scaffold, such as those which are used to hold up steel framework until it is entirely finished, is part of the place to work. The employer would be responsible for its safety to any workmen other than those who erected the scaffold.

Where the workmen furnish tools and appliances, the employer is not responsible for the condition of such tools, nor for accidents which may result from using them.

Necessity for Inspection. Where the work is construction work, so that the workmen are constantly altering it themselves, the employer is liable only for proper and reasonable inspection from time to time, and not for accidents that occur from some alteration the men have made themselves. But when men are working in a position of danger where they cannot be at the same time on the lookout for the danger and engaged in work, someone must be stationed to warn them. And, in the case of railway work, where there are low bridges which are dangerous to brakemen who must ride on top of freight cars in order to look after the brakes, some system of "tell-tales" or signals to warn them to stoop and avoid danger is necessary.

Further Liabilities of Employers. Employees are entitled

⁴ *Marbury Lumber Co. v. Westbrook*, 121 Ala. 179; 25 So. 793; 77 Am. St. Rep. 17.

to all of this protection not merely while they are at work, but also while they are coming to or going from their work over the employer's premises. Where a railroad company runs its trains over tracks belonging to another company, and an employee is injured in an accident due to defects in the track, the company is nevertheless liable to the employee. It is as much its business to inspect and see that the tracks over which it requires its employees to pass are in good condition, as it is for it to inspect cars which it receives from another company to see that they are in good condition before allowing the employees to handle them.

If an employee of the company which owned the tracks were injured by any carelessness in running a train of the renting company, however, the company that owned the train and not his own company would be liable to him for his injuries. His own company could have no control over the other company's trains, while the renting company would have control over the tracks it had rented.

Special Contracts. It is not safe for an employer to rely on special contracts relieving him from liability. They are generally contrary to some special statute, such as the Workmen's Compensation Act, for instance, or else will be held contrary to public policy.

Notes:

1. The careful employer makes use of all the safeguards possible for his employees, not merely as a matter of humanity, but as the cheapest policy in the end.
2. The theory of the law in the matter of safeguards is excellent. The practice in many cases is bad. The workman is not usually able to enforce the law against his employer and loses his job if he tries.

§ 272. Presumption with Regard to Joint Owners

When a party is hired to work in an enterprise in which two or more parties are jointly interested, the presumption is that he is the employee of both, and may hold either or both liable for the duties owed to him by an employer.

In one case, an employee was hired by Rumsey, one of the joint owners, to work on a steamboat, and received all his instructions from him. McMahon, the other joint owner, never came on the boat nor had any relations with the employee. But the court held him liable for damages for injuries to the employee.⁵

§ 273. Wages

Wages are the compensation which the employee receives for his services. He may be paid in the form of a salary, or a fixed wage, or "by the piece"; that is, the employee may be paid a certain fixed amount per dozen, etc., for the work he turns out. He may be paid in the form of commissions, i.e., a per cent of the price of goods sold, or of the amount of an insurance policy, etc. The amount of wages is determined by the agreement.

Where the wages, or part of the wages, consist of net profits, the amount of the employee's salary must not be deducted from the gross profits in computing them. Nor may interest on temporary loans be deducted. The employer cannot take out for himself interest on his investment, before computing the net profits.⁶

Wages must be distinguished from a bonus. A bonus is really a gift made by the employer to the employee. He may give it in the form of a reward for good work or may divide a certain percentage of the profits among the employees at Christmas; but in either case it is merely a gift and not

⁵ McMahon v. Davidson, 12 Minn. 357.

⁶ Morrow v. Murphy, 120 Mich. 204; 79 N. W. 193; 80 N. W. 255.

anything which the employee has earned under his contract of employment. If the bonus was specified in the contract of employment, so that when earned the employee could bring suit for it, it would be a misnomer to call it a bonus. It would be earned compensation.

The employee is entitled to the wages which he has already earned even though his employer discharges him for good cause, unless he was guilty of bad faith and attempted to injure his employer's business or use physical violence against his employer. A superintendent who had attempted to sell blooded cattle belonging to his employer for less than they were worth was refused the right to recover unpaid wages.⁷

Some states provide by law that wages must be paid in cash and make it a criminal offense to attempt to pay in orders on the company's store or merchandise. But even under such laws, the custom of issuing time checks which are redeemable in money, where the pay-days are put at reasonable intervals and not made purposely inconvenient to force the laborers to accept time checks, is permissible.

Distinction Between Wages and Salaries. These laws are generally made for the benefit of laborers and do not apply to clerical workers who draw salaries as distinguished from wages. In the same way, the wage-earners, but not the salary-earners, are given in most states the right to collect their wages through enforcing a lien on the employer's property.

The distinction is made in regard to manual labor as opposed to any other sort. Typesetters and printers come under the head of manual labor; bookkeepers and proofreaders do not.

Overtime. The law regulating the hours of labor gives the employer no right to overtime on the part of the workman unless it expressly says so. Generally, it is absolutely for-

⁷ Von Heyne v. Tomkins, 89 Minn. 77; 93 N. W. 901; 5 L. R. A. N. S. 524.

bidden to allow employees on public works to work more than the time specified, i.e., eight hours a day in New York, and private employees may refuse to work for a longer time. If employees work overtime without an express agreement for additional wages, they are not entitled to them, and if the employer permits them to work less than the specified number of hours in any day, he is not entitled to require them to make it up.

Where a contract of employment expires and the employee continues to work without any new contract, if he is performing the same kind of services as before, he will be entitled to the same wages.

Notes:

1. The agreement for wages should not be left indefinite as to hours, overtime, etc.
2. The disadvantage of the single laborer in any dispute with his employer has caused the development of the labor union and much labor legislation.
3. A minor has usually no right to his own wages, consequently an employer should not pay them to him without his father's consent, or he may find himself under an obligation to the father. The wages should be paid to the father, or his written consent to their payment to the minor obtained. In New York the statute requires the father to give notice if he claims wages.

§ 274. Fines, Deductions, etc.

Fines can be imposed only for offenses in the course of the work. In the case of *Cross v. Detroit Baseball Club*,⁸ Cross was fined \$75 for using bad language in an argument

⁸ 84 Mo. App. 526.

with the manager at a distance from the grounds. The court refused to allow the club to collect the fine.

Deductions of wages for leaving without giving notice must be reasonable in amount. The courts have held that indefinite deductions of all wages then due are unjust, because they give the employer a chance to take advantage of his employees by withholding their wages for long periods of time.

Fines for offenses must be agreed to by the employee. They should be mentioned in the agreement of employment, or posted in the rules in a conspicuous place; and the employee's attention must be called to them so emphatically that he cannot say that he was ignorant of what they were. Merely posting up rules without calling them to the employee's attention is insufficient.

Notes:

1. In making an agreement that wages may be deducted if the employee leaves without giving notice, the exact amount to be deducted should always be stated. It should be a reasonable amount, as otherwise the courts may hold the agreement unfair and refuse to enforce it.
2. Where fines are to be imposed, it is best to have a printed copy of the rules imposing them made a part of the contract of employment, or given to the employees with an announcement that these are rules for fines which they should read carefully. If any of the employees are illiterate, the rules should be explained.

REVIEW QUESTIONS

1. What degree of skill must an employee have?
2. Has an employer any rights in regard to the spare time of the employee?

3. Is a bookkeeper privileged from testifying as to confidential information?
4. What is the law as to inventions made by an employee, where no provision has been made in the contract?
5. What are the obligations of the employer? If he fails, what is the consequence?
6. What circumstances would justify discharge and forfeiture of wages due?
7. May employees be fined for coming late?

CHAPTER XLII

EMPLOYER'S RESPONSIBILITY

§ 275. Introductory

Under the common law, the employer's responsibility for injuries to his employees was reduced to a minimum.

1. "The rule as to the assumption of risk" held that if the defects of equipment were such that the employee could see them, he assumed all the risk by taking employment. As a man who needed work was not in a position to reject it because equipment was unsafe, the doctrine prevented a multitude of injured workmen from receiving damages. (See § 276.)

2. "The rule as to contributory negligence" relieved the employer from any responsibility if the workman had himself been in any way careless. Many a crippled worker was defeated in the courts by reason of this rule. (See § 277.)

3. "The rule as to fellow-servants" was a particularly unjust regulation. If the carelessness or negligence of a fellow workman caused the injury, the hurt man had no compensation. He did not hire the men with whom he worked, but the law held that if he chose to work with them, and they were careless or incompetent, the employer who had hired them was relieved of all responsibility. (See § 278.)

The injustice of these rules and the disadvantage to the injured workman when he tried to enforce his rights in the courts, have led to the passage of many laws designed to remedy the conditions. There are two classes of these laws:

1. The employers' liability laws, which aim to define the

employers' liability and to modify or remove the objectionable common law rules.

2. The workmen's compensation laws, which try to systematize the responsibility for injury and to provide something in the nature of insurance for the wounded and bereaved in the fields of industry.

These laws proceed on the theory that if a workman is injured from any cause, there is a loss that someone must stand. In such a case, it seems that the particular industry should care for those who were injured in it, and that the care for the injured should be made part of the expenses of the business, so that careless and conscienceless employers would not be allowed to shirk responsibility.

§ 276. Doctrine of Assumption of Risk

This rule of law still holds in many states where there is no workmen's compensation act, or where the workmen's compensation act does not cover all kinds of employment.

The doctrine holds that if there are dangers in the business which are sufficiently obvious for the employee to notice and recognize, he assumes the risk of accidents which may arise from them, and the employer is not liable for his injuries. The same would be true if the workman afterwards discovered dangers and remained in the employment without the employer's promising to remedy them.

If the employer assures an employee that his work involves no danger, the latter cannot be held to have assumed the risk. For instance, in *Wurtemberger v. Metropolitan St. R. Co.*, a foreman laughed at a workman when he told him that a jack was unsafe, and said to the rest, "Here is a greenhorn, and he thinks that jack is unsafe."¹ *Wurtemberger* was held to have a right to damages for the injury subsequently received. (See also §§ 279, 280.)

¹ 68 Kansas 642.

§ 277. Doctrine of Contributory Negligence

This rule holds that if the carelessness of the injured employee in any way contributed to the accident which caused the injury, the employer will not be held responsible.

It makes no difference that the carelessness of the employee was unintentional or the result of a mistake. For instance, in one case, an employee thought he was walking on a side track instead of the main track and continued walking along it until a train struck him.² He was not permitted to recover damages.

In another case, a brakeman named Quirouet left the brakes set on a freight car. Then, instead of waiting for the caboose which had steps on it, he tried to climb up and turn off the brakes so as to prevent the wheels from bursting and wrecking the train. He was injured while attempting to climb up in this way, and was not permitted to recover damages.³

Some states now have a doctrine of comparative negligence. Sometimes the accident was primarily due to the carelessness of the employer or to his neglect to perform the duties which he owed to the employee, but the employee's own carelessness had something to do with it. In this case the jury must determine what damages are due the employee for the injury, and then decide what relation his carelessness bore to the employer's carelessness or neglect of duty, and award him a proportionate amount of the damages. (See also §§ 279, 280.)

§ 278. The Fellow-Servant Rule

The fellow-servant rule means that the employee cannot hold his employer for damages if the injury was due to the act of a fellow-servant or a fellow employee. This rule, with

² *Vreeland v. Chicago, etc., R. Co.*, 92 Iowa 279; 60 N. W. 542.

³ *Quirouet v. Ala. Great Southern R. Co.*, 111 Ga. 315; 36 S. E. 599.

the doctrines of assumption of risk and contributory negligence, is rapidly being done away with.

In some states the harshness of the old law has been mitigated by the so-called superior servant rule. That is, if the fellow-employee was a superintendent or someone in a position of authority, he is not regarded as a fellow-servant and the employer is responsible for his carelessness. In some states, only an employee who has the power to hire and discharge is regarded as being a superior servant; while in others, any position of authority which gives him the power to control the actions of the men is sufficient to insure his status under the superior servant rule. (See also §§ 279, 280.)

§ 279. Employers' Liability Acts

Employers' liability acts have been passed to define and increase the liability of the employer for injuries. Most of them do away with, or at least modify, some of the old rules excusing the employer from liability. The doctrine of the assumption of risk has generally been greatly modified, and the duties of the employer to guard against accident have been increased. In New York, for instance, the employee assumes only such risks as may still remain after the employer has taken care to discover and remedy all defects, and has complied with all laws requiring safety devices.

It is under these acts that the doctrine of comparative negligence has been introduced.

Differences in Liability Acts. In order to know just what the effect on the old rules is, it is necessary to consult the particular liability act of each state, as the acts differ somewhat. Some of the acts apply only to special classes of workmen, such as miners; while others exclude certain classes, such as farm laborers. For information in regard to this also, it will be necessary to consult the particular act in question.

As a usual rule, these acts provide that the employees of a subcontractor are to be considered as the employees of the contractor also, for the purpose of claiming compensation for injuries under the act. (See §§ 259, 260.)

Notice of Accident—Time Limits. In order to obtain the benefits of bringing suit under the act, the employee must give his employer a notice—usually it must be written—of the time, place, and cause of the accident. The employee may either serve the notice personally or send it by mail to the employer's last known address. This notice must be given within a certain limited time after the happening of the accident. The time varies in the different acts, and there is generally some provision allowing the employee a certain extension of time in case of mental or physical incapacity, so that he may send the notice after the incapacity has been removed. The action must be brought within a certain time from the happening of the accident, generally varying from one to two years.

Death of Employee—Cause of Action. In case of the employee's death from his injuries, these laws give a cause of action to his personal representative, i.e., executor or administrator, or to his surviving relatives, to recover damages for the injury these relatives have suffered by his death. In such a case, the executor or administrator is allowed a certain period of time after his appointment in which to give to the employer the notice mentioned above.

This right of action in case of death is distinct from the right of the employee to sue for injuries. The employee may recover damages for his injuries; his representatives may recover only damages caused to *them* by his death. But, as a sort of additional penalty to the employer, the state of Massachusetts allows the surviving relatives to recover damages for conscious suffering endured by the employee before his death.

In order to take advantage of these acts, the rules as to the notice and the time within which the action may be brought must be strictly observed. If, through failure to comply with them, the new right of action under the act is lost, the employee still has his old action at common law for the injury which he has suffered, provided that it has not become outlawed also by lapse of time; the employee would, of course, stand a much better chance of recovering if he sued under the act. His relatives in case of his death have only the action given them by the statute. If they fail to take advantage of this action, their remedy is gone.

Some of these acts have been superseded by the workmen's compensation act discussed in the next section. In other states, as in New York, the workmen's compensation act applies only to certain employments, leaving the rest to come under the employers' liability act.

The Federal Employers' Liability Act. This act applies to all the railroads engaged in the business of interstate commerce throughout the country. It also applies to all railroads in the possession of the United States, such as those of the Philippines and Porto Rico, and in the District of Columbia. Where the railroads are engaged in both interstate and intrastate commerce (that is, both commerce which crosses the state lines and that which is carried on wholly within the state), in order to take advantage of the law's provisions the employee must, of course, himself have been assisting in the business of interstate commerce at the time the accident occurred.

However, a railroad company in contributing to an employees' accident fund may lawfully make the condition that if the employee accepts any benefit under the fund, he thereby gives up his right to bring suit. He does not make his choice as to whether he will accept the benefit or will bring suit, until after the injury has taken place.

Notes:

1. In attempting to claim damages under any employers' liability act, if it is proposed to bring an action, consult a reputable lawyer, who will be able to attend to all the necessary formalities and to secure for the injured employee his proper rights whether by suit or by compromise of the claim.
2. If you intend to sue, do not accept any benefits from insurance funds connected with the company without first consulting a lawyer.

§ 280. Workmen's Compensation Acts

With all the protections and safeguards that can be devised by science and required by law to protect the employee, there will always be certain occupations which in their very nature are dangerous to life and limb. Such are mining, building, railroading, working in atmospheres clouded by fine dust or gas fumes, etc. In the past, the loss of life and health in these industries reached alarming proportions. It has been reduced somewhat by the modern tendency to require safeguards, but the fact remains that these industries are all the time "scraping" humanity.

Since employees injured in these occupations seldom earn wages large enough to permit them to provide for the future, the burden of taking care of them and of their dependents has fallen in a large measure on the community. It seemed more just to make the industries which caused the injuries pay the expenses than to let the burden fall on the employee or on the community as a whole.

In consequence, both here and abroad there has grown up in recent years a system known as workmen's compensation.

It is part of good bookkeeping to carry a depreciation account to cover the wear and tear on mechanical machinery in a manufacturing business as a part of the cost of the product. The time has come when provision must be made for the wear and tear on the human machinery engaged in the industry which is quite as much a part of the cost of production as is the wear and tear on the plant. We are accordingly getting Workmen's Compensation Laws to protect the laborer to a slight extent against accident and to provide for his family in case of death in the course of his employment.⁴

The essential feature of this system is that there is established a scale of compensation for different kinds of injuries, by which payments are usually made at regular intervals extending over some period of time. The payment must be made, as a general rule, regardless of who was to blame for the accident, except where the employee wilfully and intentionally brought the injury on himself, or where it came about as the direct result of his intoxication.

§ 281. Modern Statutory Law

In New York State, the compensation law⁵ enumerates some forty groups of hazardous employments. The scope of the law is widened by including, as the last group:

All other employments not hereinbefore enumerated carried on by any person, firm or corporation in which there are engaged or employed four or more workmen or operatives regularly, in the same business or in or about the same establishment, either upon the premises or at the plant or away from the plant of the employer, under any contract of hire, express or implied, oral or written, except farm laborers and domestic servants.

In addition, it is provided that any employer not coming under the provisions of the law, or having some employees who do not, may choose to accept the law of his own accord.

⁴ Samuel Untermeyer.

⁵ As in effect July 1, 1919.

In other states, it applies to all occupations, or to all occupations with a few exceptions, such as farming or domestic service. In New Jersey the act applies to all classes of employees, *including* farm hands and domestic servants.

The injury must be one arising out of the employment. For instance, in a New Jersey case a workman named Hully slipped on a concrete floor while dodging away from a fellow-workman who was trying to knock his hat off. This was held not to come under the compensation act.

If the employee is injured on his way to or from work, while on his employer's premises, it is considered injury in the course of his employment and entitles him to compensation.

An injury received while he was disobeying orders would not entitle him to compensation. A man named Reimers who had been forbidden by his employer to make use of an automobile, took it out and was injured in consequence. He was not allowed compensation.⁶

An injury caused by a third person to an employee in the regular course of his work entitles him to compensation from his employer as does any other injury in the course of the employment. For instance, in one case a superintendent was shot by a man who had been annoying a woman employee and whom he had ordered off the premises. The superintendent was entitled to compensation.

§ 282. Schedules of Compensation

Each act contains its own schedule of compensation. Most of them follow the same general scheme. The following is the New York schedule of compensation for injuries:

1. Permanent total disability shall entitle the employee to receive two-thirds of his weekly wage, while he lives.
2. Temporary total disability shall entitle the employee

⁶ *Reimers v. Proctor Pub. Co.*, 85 N. J. L. 441.

to receive two-thirds of his weekly wage to an amount not exceeding \$3,500.

3. Permanent partial disability entitles the employee to receive two-thirds of his weekly wage for varying periods ranging from 60 weeks for loss of thumb to 312 weeks for loss of an arm.

In the case of death, compensation to the employee's dependent relatives is provided according to a fixed schedule. In New Jersey the scale runs as follows: For one dependent 35 per cent of wages earned until remarriage of widow or attainment of age of 18 by child. From this it increases by a sliding scale to a payment of 60 per cent of wages earned in case of six dependents. In any case, payments are not to exceed 300 weeks.

In New York the death compensation ranges from 30 to 66 $\frac{2}{3}$ per cent of wages as a maximum, and weekly payments are to continue until dependency ceases. In other states there are other variations, but enough has been cited to give a general idea of the liberality of these laws.

§ 283. Who Are Entitled to Compensation

It is generally held that in order to be an employee entitled to compensation the man must be regularly employed, and must be subject to the employer's orders as to how the work shall be done. Independent contractors and subcontractors are not employees. But the employees of subcontractors may recover compensation from the main contractor as though they were his employees. (See §§ 259, 260.)

Where there is a dispute between the employer and the employee over the amount of compensation which is due under the act, most of these acts provide for arbitration. Some of the acts provide that at any time an employer may agree with his employees to appoint a standing arbitration committee which shall decide all disputes that may arise in the future.

The law usually requires the employer to report all accidents to the Compensation Commission within a certain time after their occurrence, on penalty of paying a severe fine if he fails to comply.

Where one injury results from another, the first one being the result of the accident, the compensation must cover both. For instance, an employee was paralyzed in an accident and died of blood-poisoning from a bed-sore which came because he had to lie in one position all the time. His relatives were allowed compensation for his death.⁷

If the employee was not strong physically, a fact which rendered him more prone to accident, it would make no difference in his right to compensation for the injury. In a Massachusetts case, a delicate woman named Honora Madden, who was employed as a carpet sewer, brought on angina pectoris by pulling heavy carpets across the table in the course of her work. It was admitted that if she had been stronger the exertion would not have hurt her. She was allowed full compensation.⁸

§ 284. Employer's Defenses Taken Away by the New Act

This scheme of compensation is not made compulsory, but the same effect is accomplished by taking away all of the defenses, i.e, assumption of risk (§ 276), contributory negligence (§ 277), and the fellow-servant rule (§ 278), which the employer had at common law. The result is that the employer's chances of escaping the payment of heavy damages in a suit at law are so slight that most employers prefer to take advantage of the act.

The employer comes into the scheme by taking out insurance, or giving security for the payment of claims required by the act. After he has done this, it is assumed that each

⁷ Burn's Case, 218 Mass. 8.

⁸ Madden's Case, 22 Mass. 487

of his employees has also consented to come under the scheme unless the employee at the time he enters the employment files notice to the contrary with the employer. In New Jersey, every agreement of employment is deemed to have been made under the act, unless at the time of making the contract one of the parties notifies the other in writing that he refuses to accept the agreement under the terms of the act.

Employees Cannot Give Up Right. The acts also provide that the employee cannot make an agreement giving up his right to compensation. If he makes one, it will have no binding effect on him, and he may claim the compensation just the same.

Notes:

1. Every employer of labor should inform himself as to his responsibility under the laws of his state.
2. It is cheaper for the employer to enter the compensation scheme than to take the alternative. Where the acts allow it, most employers will find it cheaper to insure with the State Fund or some good insurance company than to risk paying for injuries.
3. An employer should select reputable physicians and notify his employees to go to them, when the act makes him responsible for medical attendance. This will protect both himself and his employees against overcharge or malpractice.

§ 285. Third Persons

Except under the workmen's compensation acts, the employer is not responsible to his employees for the acts of third persons over whom he had no control. If a train robber were to hold up a train and shoot the engineer, the railroad company would not be responsible for the affair to either employees who were hurt or passengers who were robbed.

The employer is, on the other hand, responsible to third persons for any injuries caused to them by his employees in performing their duties. If the injury is the result of some act of the employee which has no connection with his duties as an employee, the employer is not liable. If, for example, the employee should injure the third person in a fight over some personal quarrel, or in playing a practical joke, the employer could not be held to have had any connection with the matter. (See § 136.)

Where an employer is liable to a third person for injuries caused by his employees, if the third person was careless in any way that contributed to the accident, he would be prevented from recovering damages from the employer. The contributory negligence rule (§ 277) still stands in all cases so far as third persons are concerned.

REVIEW QUESTIONS

1. What three common law rules relieved the employee of responsibility for accidents? Explain the working of each.
2. What two classes of modern law modify the injustice of the common law rules as to accidents to workers? What is the theory of these modern laws?
3. What are the special features of the workmen's compensation act of your own state?
4. What are the special features of the employers' liability act of your own state?
5. Who are employees? Who are entitled to damages or compensation for an injury? What must the injured workman prove to secure damages for a personal injury in your state?
6. What should a workman, injured while employed by one not insured under workmen's compensation act, do in your state?
7. When is an employer responsible to third persons for injuries caused by his employees?
8. If a woman offers her neighbor's cook higher wages so that she leaves, is she liable to her neighbor in damages?

PART VIII
PARTNERSHIP

CHAPTER XLIII

INTRODUCTORY

§ 286. Definition

Partnership is the result of a contract between two or more competent parties to combine their money, property, skill, or labor for the transaction of some lawful business for profit.

Essential Elements. Mere representation that parties are partners, or their passive acquiescence in such representations by others, will, *as to third parties*, be sufficient to establish partnership liabilities. To form a partnership as between the parties themselves is less simple and requires the following essential elements:

1. An agreement
2. Parties competent to contract
3. Partnership capital or property
4. A community of control
5. A lawful business
6. Profit-sharing as a motive

Unless expressly stipulated otherwise, as in the case of dormant and special partners, each member of a partnership has an equal right to assist in the management of the partnership business and property, and has equal power to contract regarding it. This right may be restricted by agreement among the partners.

The business or undertaking must be lawful, and the association must have been formed for the purpose of sharing profits. An association that does not share profits is not a partnership.

Distinctive Features. The partnership relation is characterized by certain distinctive features.

1. Each partner is an agent for the others in the transaction of any business within the scope of the partnership purposes.
2. Each partner shares, either equally or in an agreed proportion, in the net profits of the business and usually in the losses also.
3. In case of insolvency each partner is personally liable for all of the firm's obligations.
4. The property, the business, firm name, good-will, and any trade-marks or other intangible possessions are firm property and form part of the common fund.
5. A partner is entitled to good faith and fair dealing from his associates, and on dissolution of the partnership may have an accounting to ascertain his interests in the business.
6. The partnership relation is a purely personal one and the partnership is terminated if any one of the partners dies, retires, or sells his interest in the firm.
7. Unlike a corporation, the partnership has no entity distinct from its membership. It cannot sue nor be sued in the firm name. It cannot contract with nor bring suit against its members, nor can they bring suit against it.

§ 287. Partnerships Distinguished from Non-Partnership Organizations

Co-ownership in either land or personal property does not involve any partnership between the owners.

Associations not formed for profit are not partnerships. The many unincorporated clubs, churches, societies, associations, and fraternal organizations are not partnerships and do not

involve mutual agency nor partnership liability. Co-operative societies which buy goods and *distribute* them among their members are not partnerships unless formed for the purpose of making a profit. In some states business organizations designated as partnership associations are authorized by law. These are neither partnerships nor corporations, though they partake of the characteristics of both. (See § 293.)

Contracts That Are Not Partnership Contracts. Contracts are frequently made for a share of profits as compensation for services, for the use of property, or for the loan of money. In the first two cases, if the agreement was made in good faith and not to evade the law, the contract will not be held to create a partnership. Where money is loaned, and an agreement is made in good faith to give the lender a share in the profits as compensation for its use, and he does not participate in the management of the business or hold himself out as a partner, the contract will not in most states be considered one of partnership. It is safer to have the agreement expressed in writing, as under the old rule of law the parties became partners under such an arrangement, and in some states it is necessary to have a written agreement to prevent this effect.

A contract of the above nature should provide for the return of the money loaned without reference to profits. Where such a contract concerns the use of property, the title to the property should be carefully reserved to the owner. In all cases where profits are taken without partnership intent, it is prudent to specify in the contract that the party shall receive as compensation "an amount equal to" the proposed share of profits.

If in any of the cases of profit-sharing discussed, the agreement is made for a share of the "gross returns," this wording shows conclusively that the arrangement is not a partnership. The usual arrangement for renting land for a share of the crops raised is an example of this form of contract, and

neither as between the parties themselves nor as to third persons would the relation be one of partnership.

Liability to Third Parties. In dealing with this question it is to be emphasized that *as to third parties* it is the apparent intention of the parties rather than their expressed or declared intention which controls. If the acts of the persons under consideration are such as to mislead third persons into believing them partners, they will have to assume the liabilities of partners to such third parties. As between the parties to the agreement, however, the true rule is that "the agreement and intention of the parties themselves should govern in all cases." (See §§ 295, 299.)

Notes:

1. A contract for a share in the profits not intended to create a partnership should always be in writing and provide either for "an amount equal to" the agreed share of the profits, or for a share of the "gross returns," and not for "a share in the profits."
2. Such a contract should also provide that the person with whom the profits are to be shared is not to be a partner, and is to have no control of the business nor liability for its debt.

REVIEW QUESTIONS

1. What is a partnership? What are the essential elements?
2. What may cause a person to be held liable as a partner by third parties?
3. How is a partner an agent?
4. Must each partner have an interest in both profits and losses?
5. What is meant by partnership liability?
6. Distinguish between the legal character of a partnership and a corporation.

7. Distinguish between partners in general business and partners in common of a tract of land.
8. How may clubs, associations and the like be distinguished from partnerships?
9. Can a person have a share of profits as compensation for services or use of property without becoming liable as a partner?
10. Why does a different legal effect attach to a share of "gross returns" and a share of "net profits"?
11. What determines the liability to third parties?
12. If a man is interested in the profits of a business, is he necessarily a partner therein? Explain answer.
13. A and B were partners. C was a salesman for the firm, and for his services he was paid one-tenth of the net profits of the firm. The firm owed D \$1,000 on an open account, and D sued A, B, and C as partners. Is C liable as a partner or not? Why?
14. The president of a non-incorporated club buys some furniture for the club. Will the members be liable for the cost of the furniture? Why? Will any of the members be liable?
15. A was a horse-trainer and B the owner of a race-horse. They made an agreement whereby A was to keep, train, and control the horse, and both A and B were to divide the expenses and the winnings. Was this a partnership arrangement?
16. A makes a loan to the firm of X, Y & Co., who agree to pay him a certain percentage of the profits. Does this arrangement constitute A a partner of the firm?
17. A and B make an agreement whereby A agrees to run B's factory and B agrees to pay A a certain percentage of the profits. Is this a partnership arrangement?
18. B and L make an agreement whereby B furnishes a farm, team, and some labor, and L furnishes the greater part of the labor and agrees to manage the farm. The profits are to be divided as follows: two-thirds to B and one-third to L. Is this a partnership agreement?

CHAPTER XLIV

THE CONTRACT OF PARTNERSHIP¹

§ 288. Parties

As partnership is strictly a contract relation, it is essential that the parties to it be competent to contract. (See under § 38.)

If a minor becomes a partner, his acts will bind the firm, since a minor may act as agent. Should the firm become insolvent, however, the minor may take advantage of his infancy, refuse the partnership liability, and leave his associates to bear the entire burden of the partnership obligations, including those which he himself created, but he cannot withdraw any capital he may have invested in the firm.

A partnership may be entered into between two firms already existing, or between a firm and an individual, as readily as may any other contract. Under such an arrangement the profits, and in case of dissolution the assets, are divided among the component firms or parties, and then subdivided by the firms among their individual members. The individual members of both firms are personally liable to third parties.

A corporation cannot become a partner unless expressly authorized to do so by its charter. It may, however, make itself liable to third persons as a partner if it attempts to enter into partnership relations.

Note:

1. Any person who is capable of contracting may become a partner. Corporations, before they may

¹ For forms of partnership contract, see Chapter CV, Forms 50, 52.

become partners, must be expressly authorized by their charters to do so.

§ 289. Kinds of Partners

Partners are of various kinds. There may be general, limited, dormant, and nominal partners.

General Partners. A general or active partner is one who takes part in the management of the business, and who is liable for the firm's obligations without limitation as to amount. An active partner who wishes to withdraw from the firm and cut off subsequent liability, must give notice to all those with whom the firm is doing business.

Limited Partners. A limited or special partner is one who does not participate to the full in partnership liability. As the price of his limited liability, such a partner must refrain from taking any part in the management. Limited partnerships are formed only where authorized by special statutes. (See § 293.)

Dormant Partners. A dormant or sleeping partner is one who has invested as a partner but whose connection with the firm is secret and who has no part in the management of the business. A dormant partner has no exemptions or privileges beyond those of a general partner, except as a result of the secrecy. If this connection with the firm is discovered he is liable in exactly the same way and to the same extent as any general or active partner. Unless prevented by the partnership agreement, he may at any time assert himself as an active partner and take part in managing the firm business.

A dormant partner who withdraws without giving notice cannot be held to any subsequent liability of the firm, even though his previous connection with it should become known. His withdrawal, however, does not free him from liability for anything done by the firm during his connection with it.

Silent Partners. The term "silent partner" is often used

with much the same meaning as "dormant partner." There is, however, this difference: a dormant partner must be both "secret" and "silent," while a silent partner need not be secret. A silent partner has no voice in the management of the firm business, but may be publicly known as a partner. He is liable for firm obligations just as is any other partner, and if he withdraws, he must give notice to escape subsequent liability.

Nominal Partners. A nominal partner is one who, while not really a partner, in that he has no interest in the business or profits, allows his name to be used or to appear as that of a partner. He is held liable to those who give credit to the firm on the faith or with knowledge of his being a member. He is not, however, liable to a creditor who had no knowledge of his being held out as a partner when the credit was given.

Subpartners. A partner may agree with an outside party to share his interest in the profits and property of the firm. Such an arrangement is termed a subpartnership. It may be entered into without the consent of the firm, and without affecting in any way its existence or operations. The subpartner is not a member of the original firm, is not liable to its creditors, and, under ordinary circumstances, has no right of accounting against it.

Notes:

1. Limited partners should always take care to see that the proper notices and other regulations required by the law of their state have been given and complied with.
2. A retiring partner should take care to see that all those with whom the firm has had dealings are notified of his ceasing to be a member of the firm.
3. A nominal partner is liable only if he permitted his name to be used. One cannot be made a nominal partner against one's will.

§ 290. Partnership Contracts

The customary and the only proper method of forming a partnership is by written articles of partnership signed by all the parties. These articles may be a very simple memorandum of agreement, or they may be expanded into elaborate articles of association, providing for the numerous details and possible exigencies of an extended commercial enterprise.

In spite of the dangers of such a course, partnerships are frequently formed by oral agreement. Under the Statute of Frauds, an oral contract of partnership to last more than a year is not valid. If, however, immediately upon making such a contract, the parties thereto enter upon its performance, a partnership at will is thereby formed, which is legal and is governed as to its terms by the contract, but which may be terminated at any time by either party, regardless of the terms of the contract.

It must be borne in mind that the Statute of Frauds does not apply to oral contracts that may be performed within a year. Such contracts are binding for the specified length of time, and cannot be dissolved at will without incurring a liability for damages.

In many cases of partnership there is neither a written nor a verbal contract which can be proved, but the parties concerned, either intentionally or unintentionally, have acted as partners, have had a common fund in which they exercised a community of interest, and have shared profits and losses. Under such circumstances they will be held to be partners, both as between themselves and as to third persons.

This same principle applies to the case of parties who assume to be incorporated when they are not. It does not apply to those who have attempted to incorporate legally, but have failed in some point of procedure; they would be held to be a *de facto* corporation and as such capable of doing business.

Laws Regulating Formation of Partnerships. Most part-

nerships are formed under common law rules that are the same in every part of the Union. In certain of the western states, however, codes of partnership law, intended to regulate general partnerships, have been enacted. Entirely apart from these general partnership codes, nearly all the states have provided for the organization of partnerships with special or limited partners. The Uniform Partnership Act, prepared and recommended by the National Conference of Commissioners on Uniform State Laws, has been adopted in Maryland, Pennsylvania, Wisconsin, Illinois, Michigan, Wyoming and Tennessee.

Notes:

1. The contract of partnership should always be in writing.
2. The state partnership law should always be consulted in the formation of any partnership, and especially in the case of a limited partnership.

§ 291. The Firm Name

The usual practice where there are two partners is to use both names; the name of the leading partner naturally coming first. If there are more than two partners, all the names may appear, though this is unusual in mercantile partnerships. Usually but one or two names appear, the other names being represented by the addition, "& Co." Professional partnerships on occasion use three and even more names in the firm title.

In the absence of statutory restriction any title that is preferred may be used as a firm name, even though it contains no partner's name, for instance, such a name as "The Ansonia Furniture Company." In New York and some other states a firm using any name other than the names of the partners or some of them, must register such "trade-name," together with

the real names of the partners, in the county clerk's office, under legal penalty. It is also illegal in New York to use the suffix "& Co." unless it represents existing or former partners. Partners may change the firm name without dissolution or any special formality, or may have more than one name for the firm.

All business of the firm should be done under the firm name, although a partnership may exist and be bound without any specific firm name by using the separate names of the partners. The firm signature, as "Herrick, Simpson & Co.," may be written by a partner or by any agent of the firm. If suit is to be brought the names of all the partners must appear in the pleadings. The usual form is "Anselm Cole, Harvey Andrews and James Ellis Jones, partners under the firm name of Cole & Co."

§ 292. Partnership a Personal Relation

It must be remembered that partnership is a personal relation. Such skill and experience as one partner may possess above the others constitute as legitimate a form of investment as any other kind of capital. In many cases these are taken as the full equivalent of the financial investments of other members of the firm. In others, they are regarded as a partial equivalent, and in still others extra abilities are recognized by a special salary or a larger percentage of profits.

As partnership is a personal relation and as one reckless partner may bankrupt his associates, the selection of partners is a vital matter. No one can be forced to accept a partner he does not like. So a new partner may not be admitted except with the unanimous consent of the entire firm.

Because of the importance of the personnel, the death of one partner will ordinarily dissolve the firm.

Note:

1. Partnership is a personal relation and a partner should always be a man who can be trusted.

§ 293. Classification of Partnerships

Partnerships may be roughly divided into two classes, general and special. While this classification covers the majority of cases, there are a few forms involving peculiarities of partnership law, such as limited partnerships and joint-stock companies, which require separate discussion.

A general partnership is the usual partnership formed for the continued prosecution of some general line of business. It is the commonest form of partnership. General partnerships may be either trading or non-trading.

Trading partnerships include all those formed for the purpose of buying, selling, and manufacturing.

Non-trading partnerships do not buy, sell, or manufacture as a principal feature of their business. These partnerships include professional partnerships, firms of brokers, etc.

A special partnership is formed for the transaction of some single piece of business, or for the conduct of some one line of business. Examples of special partnerships are as follows: a partnership to buy and sell some definite piece of land, to ship a cargo to some particular place, to buy and operate a threshing machine, to finance and sell a particular patent, or to deal in specified stocks. A common form in the present day is the syndicate organized for the promotion or financing of some large corporate enterprise. Special partnerships are often termed "joint ventures." It is to be noted that a special partnership means one undertaken for a special business, while a special partner simply means a limited partner.

A limited partnership may be formed only under special statutes. It differs from the ordinary partnership in that certain of its partners are silent, or inactive, and the liability of

these partners is limited to the amount actually invested by them. These partners are called special partners. If a partner whose liability is thus limited takes active part in the conduct of the partnership business, his status changes and he at once becomes liable as a general partner.

The restricted liability enjoyed by the special partner can be secured only by strict compliance with the statutory directions. These usually prescribe notice to the public of the formation and nature of the partnership and require that a certificate and affidavit of the limitations of the partnership be filed in some office of public registry. In New York a limited partner must contribute his capital in cash. In all cases the local statutes should be examined, and their directions followed implicitly. In a New York case a limited partner was held by the courts to be in fact liable as a general partner merely because the affidavit—stating that cash had been paid by the limited partner—was filed at a time when he had in fact given only a check dated a few days in advance.

A joint-stock company is a form of business organization formerly popular but now practically obsolete. It is not organized under any statute, and, though usually adopting a corporate name and having some of the features of a corporation, is merely a copartnership, and the shareholders are responsible for the debts of the company as in partnership.

An important difference between such an organization and an ordinary partnership is that its members may transfer their interests exactly as stockholders do in a corporation. If there are many members, affairs are usually managed by a board of trustees or managers, and the individual members have no authority to act in the company affairs.

In New York and some other states various forms of joint-stock companies, partnership associations, and other ambiguous organizations between partnerships and corporations are authorized by statute. These statutes and the deci-

sions of the state courts construing them must be consulted to ascertain their legal status.

REVIEW QUESTIONS

1. What is the law as to a minor's becoming a partner?
2. What is a general partner? A limited partner? A dormant partner? A nominal partner? A subpartner?
3. What is a limited partnership? What does your own state law prescribe for the formation of a limited partnership?
4. What is a partnership at will?
5. In the event that the name of a partnership does not clearly indicate who all the principals of the firm are, what is necessary for such a firm to do in order to bring suit?
6. Why should a partnership agreement be written? How can parties drift into a partnership?
7. What is a special partner? What is a special partnership?
8. What are the peculiarities of a joint-stock company?
9. What matters should be specified in articles of copartnership?
10. Prepare a short form of partnership agreement for equal partners.
11. Prepare a copartnership agreement that shall provide for a period of five years notwithstanding the death of one of the partners in the meantime, and provide also for payment of interest on investments, salaries to partners, and a method of determining and apportioning profits and losses.
12. A buys the share of M in a partnership composed of M, N, and O. Does that make him a member of the firm? Explain answer.
13. B withdraws by agreement from a firm of which he has been a member, but no announcement is made and he allows his name to be used on the letterhead. The firm becomes insolvent. What is B's position?

CHAPTER XLV

PARTNERSHIP PROPERTY

§ 294. Nature of Partnership Property

The partnership investment is the money or property, tangible or intangible, contributed by the partners for the purposes of the business. The original property of a partnership is derived from the contributions of the partners. When profits are made, they may be drawn out, or they may be allowed to accumulate and meanwhile may be used in the prosecution of the firm's business. If retained in the business they are practically merged in the original capital, the two together constituting the partnership property.

Any property purchased with partnership funds becomes *prima facie* partnership property. If such property is taken in the name of a single partner, he holds as trustee for the firm. The firm name, the good-will of the business, and any trade-marks used in the business are the property of the partnership, in which each partner has his interest.

When the business is sold, the firm name passes with it. If the business is sold as a whole, the good-will passes with the firm name and the tangible assets.

A firm as such cannot hold real estate. Hence, land must be deeded to the members of a firm to hold as tenants in common, or to some individual, who is usually a member of the firm, to hold as trustee for its benefit. A conveyance of real estate to a firm by name, in cases where the firm name contains the name or names of existing members, passes a legal title to the members named, who will hold in trust for

the whole firm. If no member is named in the firm title, no title passes to anyone, but the seller can later be compelled to deed to the individual members of the firm.

Real estate held for the benefit of the firm is, for all partnership purposes, treated as personal property. The money or property invested in a partnership and any property acquired by the firm is partnership property. Each partner may deal with it in the firm business as an agent of the firm, but he has no personal right to any of it.

A partner has no claim to interest on his investment, nor even to interest on money put in, over and above his agreed investment, unless it has been expressly so agreed. It is always possible for a partner to advance money or to let the firm have the use of property of which he retains the right to possession, and such money or property remains his individual property. Money or property, however, put into a partnership *as an investment* becomes the actual property of the partnership.

Power Over Personal Property of Firm. Each partner's power over the property of the firm is the same. Each is agent for all the others in everything that pertains to the care, sale, and management of the partnership property.

A partner has full power to buy and sell personal property within the scope of the partnership business, and the firm is bound by his transactions. This power does not extend to the sale of property used by the firm for carrying on the firm business, as such a sale would tend to destroy the partnership business. Where a sale is to be made of the stock in trade, or of the entire assets, or of fixtures or furniture, all of the firm should join in the assignment.

Power as to Real Estate. One partner cannot make a valid deed to real estate held by the firm, but he can, when such contract is within the scope of the partnership business, make a contract to convey, which the courts will compel the firm to

perform. Likewise, in a similar case, a partner can make a valid contract for the purchase of land by the firm.

A partnership may be formed by either written or verbal contract for the express purpose of buying and selling real estate. In such cases the realty is treated for all partnership purposes as if it were personalty.

For a legitimate purpose a partner has also the right to pledge or mortgage the real property of the firm. He has, however, no power to sell property of the firm or to borrow money upon it for his own purposes or to pay his own debts, and anyone lending him money, or buying property from him under such circumstances, with knowledge, takes no title to the property in question.

The wife of a partner has no right to dower in real estate held for the purposes of the firm until all the claims of creditors and of all the other partners have been satisfied. In a solvent firm, however, the wives of the partners would be entitled to dower, and when such property is sold the wives should release their dower rights.

Notes:

1. A partner has a right to make use of firm property for the purposes of the business in common with all the other partners.
2. He has no right to firm property personally until the firm has been wound up and the assets divided, unless he has loaned property with the express provision that it is to remain his individually.

§ 295. Liability of Partnership Property for Debts

A partner's interest can be reached by attachment or by execution. This interest, however, is merely a right to a certain proportion of the surplus after debts are paid and the affairs of the partnership are adjusted, and this is all that can

be reached by legal process. The effect of the sale of a partner's interest under execution would be to give the purchaser the right to merely the same interest in value that the debtor partner had. Such a sale would make necessary the dissolution of the partnership, and the immediate settlement of its affairs, for all partnership debts must be settled before anything is set aside for a purchaser under execution.

Execution following judgment on a claim against the firm runs in the names of the individual partners, and can be levied on the partnership property, or on the individual property of any of the partners. If it is levied on individual property, the partner to whom such property belongs has recourse against the other partners for their proportions of the debt.

In event of insolvency the partnership assets should be applied to the payment of the partnership debts, and the separate assets to the payment of the individual debts, and any surplus from either class should be carried over to the payment of the other class. This process is called "marshaling the assets."

On execution against the partnership there can be no claim for homestead or exemption out of the joint assets. This is the general law, but it does not apply to New York and a few other states, in which the provisions of the exemption law extend to property owned by a partnership of which the debtor was a member. (See § 300.)

Assignment for Benefit of Creditors. An assignment for the benefit of creditors can be made only by all the partners acting together. If, however, one partner makes such an assignment, the others may, if they choose, ratify his action, thus making the unauthorized assignment valid. In case a partner has absconded, or cannot be reached, the remaining members of the firm, acting together, may make a valid assignment.

It has, however, been held in New York that one partner

may transfer the partnership effects directly to a creditor of the firm, without the knowledge or consent of his associates, and that the courts will sustain his action.

Under the National Bankruptcy Law, however, in any case where an assignment is made when the firm is insolvent, any aggrieved creditor may proceed under the Bankruptcy Act.

For the liability of individual partners to third persons, see §§ 287, 300.

Note:

1. If an assignment of partnership property has been made, any creditor can institute bankruptcy proceedings.

§ 296. Profits

The sharing of profits is an essential feature and the usual object of a partnership. Ordinarily these profits are ascertained by deducting the current expenses from the current receipts, or gross profits, or, on dissolution or any general accounting, by deducting the firm indebtedness and the original partnership investment from the total partnership assets. As there is often room for differences of opinion as to what constitutes profits, it is well to define in the articles of association how they are to be determined.

In the absence of a special agreement otherwise, the common law rule governs the division of both profits and losses. Under this the partners must share equally, without any variation, or any allowance for the greater value of services rendered, the greater amount of time devoted, or the greater investment made by one or the other of the partners. This is usually arranged by agreement, however, so that partners who devote more time or money to the business, receive a more nearly commensurate return. Salaries for services and interest on investments are sometimes provided for in the partnership agreement.

The rule of good faith requires that all profits made within the scope of the partnership business shall be turned in for the benefit of the entire firm. If any partner violates this rule and uses his position in the firm and the knowledge he has of the business to secure any secret rebates, commissions, or other profits for himself, he will, if discovered, be held liable to the firm for the amount so realized.

If a partner uses firm funds in his private speculations he can be compelled to account for any profits. If the result is a loss, he must bear this himself, returning the partnership funds intact. This rule also applies to the use for private gain of time or skill which should be applied to the firm business.

Right to an Accounting. Every partner is entitled to have accurate accounts kept. The right exists whether or not any reference has been made to it in the terms of agreement. This makes it the duty of each partner to keep an accurate record of his own transactions concerning the firm business. If, as is usually the case, some one partner or some particular employee is designated to keep the firm's books, it is the duty of each partner to furnish such accountant full information as to his transactions.

It is also the right of every partner to have access to the firm's books and accounts and to make extracts therefrom.

In closing the books to ascertain amounts due partners the partners are bound by a bookkeeper's statement either by mutual signature thereto, or by failure to object within a reasonable time after submission to them of the statement, or by any action which would imply acceptance.

Notes:

1. Any proposed extra share of profits to any partner should be specified in the partnership agreement.
2. The books of account should always be kept at the office of the firm, or, if it has more than one, at the principal office.

3. Partners should make every effort to keep their accounts straight, for, if the accounts have been garbled or falsified or the books mutilated, every presumption will be allowed against the partner who is at fault.
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REVIEW QUESTIONS

1. What is the capital of a partnership?
2. What does the partnership property include?
3. May a firm pass title to personal property of the partnership by bill of sale in the business name of the firm?
4. May a member of a firm sell out the entire assets?
5. Can a partner sell firm real estate?
6. May a good title to firm realty be passed without the wives of the partners joining in the deed?
7. A and B are partners. C recovers a judgment against A for a personal debt, but can find no personal property on which to levy. What can C do? What effect has the bankruptcy of one of the partners upon the partnership?
8. Define partnership profits. What is the general rule for division of profits? If the partnership agreement merely provides for division of profits, how will losses, if any, be borne?
9. A firm composed of three members was about to dissolve partnership and go out of business. It occupied, and had for many years, premises which the firm leased and did not own. One of the members, without the knowledge of his copartners, obtained a lease of these premises some time prior to the dissolution of the firm, but when it was contemplated; the new lease to begin when the old one expired. After the dissolution, he sold the lease for a large sum of money. Is he under any obligation to account to his partners for the profits thus realized as if the same were partnership property? Give reasons for your answer.
10. A and B are in partnership under a written agreement whereby A because of his greater investment and experience is to have two-thirds of the profits, nothing being said as to losses. At

expiration of one year the firm dissolved, having lost \$5,000. How will this loss be apportioned? Why?

11. When a judgment is obtained against a firm, can execution be levied on the personal property of the members?
12. How should the assets of a copartnership, and the assets of the respective individual members thereof, be applied when the several members owe individual debts in addition to the debts owed by the copartnership?
13. In closing books to ascertain amounts due partners, what is it necessary to do in order to bind partners to results shown?

CHAPTER XLVI

POWERS AND LIABILITIES OF PARTNERS

§ 297. Powers of Partners

In a partnership each partner has equal authority with the others and is held to be the agent of the others, and of the firm, for any transactions within the scope of the partnership business. Hence each partner within this limit is bound by the acts, the contracts, and even the frauds of his associates, and is responsible for the obligations and liabilities so created as fully as if he had himself acted or contracted.

In the absence of special restrictions on the agency powers of the partners, they are limited only by the scope of the partnership business and by the ordinary limitations of the powers of agents. Thus, under his general powers, a partner acting alone may bind the firm in any matter properly within its business operations. He must, however, be authorized before he can bind it by executing a sealed instrument in the firm name.

Partnership notes, as firm obligations, come under the general rules for mutual agency. Every member of a trading firm has a right to make and indorse notes, and to make, accept, and indorse drafts and other commercial paper in the firm name. One of the members may use this power fraudulently, or for his private benefit, but, unless the payee or owner of the note is aware of this fact, the firm is liable on the note.

In the case of a non-trading or professional partnership, however, it is not customary for the partners to bind the firm by issuing negotiable paper, and unless it can be shown:

(1) that the partner was authorized to issue commercial paper, or (2) that in the particular business it was in accordance with usage for the partnership to bind itself in this manner, the firm is not bound.

If the business does not require notes or contracts, any such instrument signed by a partner with the firm name may be rejected or accepted at discretion by the firm. If rejected, it cannot be enforced against the firm, though the partner signing would be liable.

A person with a claim against a partner cannot safely take in settlement a note signed by him with the partnership name, as such an act would be clearly beyond the ordinary authority of the partner, but if such a note were issued and was passed on for value to an innocent holder it would bind the firm. An indorsement of the firm name by a partner on the note of a third party, outside of the scope of the partnership business, would be void.

It is always possible to restrict the powers of any one or all of the partners as among themselves by limitations in the articles. Such restrictions do not, however, affect third persons, unless they have had notice of the same. In a limited partnership, the partner whose liability is limited can take no part in the management. In such a case the limitations of his powers and the general nature of the partnership are notified to third parties under the provisions of the laws regulating such partnerships.

The majority rule in a partnership, each partner being entitled to an equal voice in the management of its affairs without regard to the amount of his investment. The majority may decide all matters of business policy and all questions relating to the general conduct of the business, and when and to what extent profits are to be divided, so far as these matters are not prescribed in the articles of copartnership. The majority must, however, in all cases rule fairly, must

consult with the minority in regard to any proposed action, and must allow the minority to be heard in discussion of the same. They cannot apply the capital to new undertakings outside the scope of the partnership business, nor can they seek their own interest as against the common interest.

Where the partners are evenly divided concerning any proposed action, a deadlock results and those who want to make a change are at a disadvantage. In a partnership of two no change can be made and no new action undertaken unless both can agree. Where articles of copartnership exist no change can be made in any part save by unanimous consent of all the members of the firm. Disputes among partners generally result in dissolution and final accounting. Some partnership agreements provide for arbitration, but the courts generally refuse to sustain arbitration and decree a dissolution instead.

A single partner, by reason of his powers as an agent of the firm, may often commit his associates to action against their wishes. In such case, the only remedy is to dissolve the partnership.

A partner as such does not generally have authority to do any of the following acts, except where his partners have wholly abandoned the business to him or are incapable of acting:

1. To confess judgment.
2. To dispose of the good-will of the business.
3. To make an assignment of the partnership property to a creditor, or to a trustee for the benefit of a creditor or of all creditors.
4. To do any act which would make it impossible to carry on the ordinary business of the partnership.
5. To submit partnership claims to arbitration.

As to partner's power over firm property, see § 294.

Notes:

1. If any restriction is to be made on the agency powers of a partner, all those dealing with the firm should be notified in order to protect the firm.
2. A person dealing with a partner is bound to know what the nature of his business is, and it is his own fault if he accepts notes and contracts that are void because they are not within the limits of the partnership business.
3. If a partner is not trustworthy, he may bind his co-partners without right.

§ 298. Liabilities to Copartners

Partnership is practically a personal relation, and those who enter it are expected to act honestly and fairly toward their associates. No partner may seek his own advantage at the expense of his associates, nor may he make any personal and private profit out of a transaction in the line of the partnership business. All transactions must be for the common good, and in important matters a partner should consult his associates before taking action.

A partner will not be allowed to retain an unfairly made profit, nor to compete with his firm. He may, unless expressly restricted by his partnership agreement, carry on an independent non-competing business of his own, provided that it does not interfere with his duty to his firm. Any profit made in a competing business, or in a business that did interfere with the firm business would be held to have been made for the firm, and the other partners could compel their associate to account for his unfair profits. He would be a trustee for the firm for any gains made. A partner would also be a trustee for any property purchased in his name with partnership funds.

In the absence of any restrictions in the articles, a partner

may give to non-competing ventures time which might have been devoted to partnership affairs. He may also use information acquired by him in the partnership business in his private undertakings, provided these latter are not within the scope of, and do not compete with, the business of the firm.

Notes:

1. Good faith is necessary in all dealings between partners.
2. The partnership agreement should provide that each partner shall give his whole time, or a specified part of his time, to the partnership affairs.
3. A partner can retire at any time and so dissolve the partnership.
4. A retiring partner should examine the local laws with care to make sure he has complied with the legal requirements for notice of the severing of his connection with the firm.

§ 299. Intra-Partnership Relations

A partnership is not a separate entity as is a corporation. It cannot sue or be sued in the firm name. Suit against a firm or by a firm is a suit against or by the individuals who comprise it. Therefore a partner cannot sue the firm, neither can the firm sue one of its members.

In event of partnership controversies, which cannot be settled by conference, by buying out one or more partners, or by arbitration, the only recourse is a dissolution and accounting.

A partner cannot sue another partner for any matter relating to the partnership but can sue him for any individual cause not relating to the partnership.

Two partnerships having common members or a common member cannot bring suit against each other. In some partnership cases when actions at law will not lie, an action may be brought in equity but in such case it usually means the

dissolution of the firm. The general rules of equity in partnership cases are:

1. Not to interfere except to dissolve the partnership.
2. Not to interfere in internal disputes.
3. Not to interfere on behalf of the offending party or where the party applying has been negligent in making application.

In some cases, however, a court of equity will grant an injunction without decreeing a dissolution. It would require legal advice to ascertain when the aid of equity can be had in a partnership controversy.

§ 300. Liabilities to Third Persons

Where a partnership is admitted or proved, and where a contract within the scope of the partnership business has been made by a partner, each individual partner is liable, and in case judgment is had against the firm, executions may be levied on the firm property, or on the separate property of any one of the partners. That is, the creditors may take judgment against all the partners and may then proceed to collect their claims from firm assets or from the property of any one or more of them, leaving the partners to adjust the matter between themselves afterward as best they may.

A partner is liable in damages for the torts, frauds, and wrongdoing of his partner within the scope of the partnership business, but usually he will not be held criminally liable.

A partner who has been taken in after the partnership has been formed is not responsible for obligations or acts of the firm prior to his entrance, unless he expressly assumes them.

Notes:

1. In order to enforce partnership liability, third persons must as a rule prove the existence of a partnership.

2. The onerous character of partnership liability demands prudence in selecting a partner.
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REVIEW QUESTIONS

1. What relation of a partner to the firm gives him authority to act? What is the limit to this authority?
2. Has a partner authority to make and indorse commercial paper for his firm? If he discounts the firm note for his own benefit, is the firm liable? What is the rule for professional partnerships?
3. What effect do limitations on partners' powers in articles of copartnership have on outsiders?
4. A sells goods to a partnership on the customary terms in his line, namely, four months' credit. The goods are delivered and used by the firm, but when the amount is due, payment is refused on the ground that the partnership articles stipulate that no partner shall bind the firm to a time-purchase contract, but that all purchases shall be cash. A knew of this agreement. Can he recover? Explain the theory.
5. How are differences of opinion settled in a partnership?
6. What things are beyond the authority of a partner to do unless specially authorized?
7. May a partner take part of his time for his own affairs? What is the effect if he engages in a business that competes with the firm business?
8. Can a partner sue another? Can one partner bring suit against the firm? Can the firm bring suit against one of its members?
9. May one partner bring suit against another for what may be due him on partnership account?
10. If a partner buys a debt against his firm, can he collect it by law?
11. What is the liability of an incoming partner?
12. Is the new member liable to creditors of the old firm by a contract made with the members of the old firm to assume the old debts and be liable for them as old members?
13. When would a partner be a trustee for his firm?

CHAPTER XLVII

TERMINATION OF PARTNERSHIP

§ 301. Termination by Agreement

Upon the expiration of its term as limited by the partnership articles, the partnership will be dissolved in any particular manner prescribed by the articles, or, in the absence of such provisions, in accordance with the rules of law.

A partnership may be dissolved at any time by unanimous agreement regardless of the period fixed by the articles. If any of the partners wish to continue the business, they may buy out partners who wish to retire or who are dissatisfied.

In many cases the most satisfactory method of disposing of a partnership business worth preserving, is by incorporation. This is preeminently a dissolution by agreement. (For methods of incorporation, see Chapter L.)

§ 302. Enforced Dissolution

A partnership may be terminated by the death or bankruptcy of a partner, or by the sale of his interest. It may also be dissolved because of the impossibility of continuing the business for any reason, or by the bankruptcy of the firm. Mere insolvency may exist for an indefinite period without affecting the partnership relation, but an assignment by the firm for the benefit of creditors, or an adjudication of bankruptcy terminates the partnership.

If a partner sells his interest in the firm to a stranger, it would usually terminate the partnership. Neither the stranger nor the other partner or partners, can be forced to accept

each other as partners and either can take steps to wind up the firm's business.

If a partner wishes to terminate his partnership relations, he may do so at any time simply by giving notice: (1) to the members of his firm, (2) to those dealing with the firm, and (3) to the public generally. If the partnership was for a given term which has not expired, the partner may be liable in damages to his associates for his breach of the partnership contract, but he cannot be compelled to remain.

After giving proper public notice of his withdrawal, the retiring partner is no longer liable for the future transactions and obligations of the firm. He remains liable, however, on the obligations contracted while he was a member of it. The matter of notice is important, as it is the only way in which liability for the future obligations of the firm may be escaped.

Owners of a business concern which had changed from a partnership to a corporation have been held personally liable for the debts of the corporation because they neglected to notify those with whom they were dealing that the business had been incorporated.

When a partner dies or becomes bankrupt, or when war is declared between the countries to which the respective partners belong, the partnership is forthwith terminated, the relation of mutual agency ceases, and neither a partner nor the representative of a partner can bind the partnership or the property or estate of either partner further. Nothing can be done except to liquidate, pay debts, and wind up the partnership affairs.

The insanity of a partner does not work a dissolution, but may be a sufficient reason for asking a dissolution by decree. If the insanity is temporary, the courts will not decree a dissolution.

Where it becomes apparent that only loss can result from the further prosecution of the partnership business, any part-

ner, if his associates will not agree to a peaceable termination of the business, can obtain a judicial dissolution.

A breach of the articles of partnership by any of the partners, bad faith, or misconduct so serious as to affect the credit and success of the business or to make it impossible for his associates to work with him, is good ground for dissolution.

In case a person has been induced to enter a partnership by false representations, he can at once dissolve the firm or bring suit to have the whole contract rescinded and cancelled.

In all of these cases, proceedings may be instituted to have the partnership dissolved and to secure an accounting. If necessary, an injunction may usually be had restraining the defendant partners from making new firm obligations, from interfering with or disposing of firm property, or from further conduct of the firm business. The appointment of a receiver is an extreme measure to be resorted to only when the interests of some member of the firm, or of outside creditors are in urgent need of protection. The courts are slow to grant it.

The right to an accounting is a necessary corollary to the right to profits. An accounting is a necessary incident of a dissolution unless the parties have already agreed upon a settlement, which would be a bar to the right. The usual procedure is to appoint a referee, or refer the accounting to a Master in Chancery to examine and report the terms of the partnership, the accounts that have been kept, the capital invested and withdrawn, the profits and the losses, the assets and liabilities, and the proportion in which these should be shared among the partners. The court then makes its orders in accordance with this report, and the receiver, or the partner or partners in charge, will close up the business pursuant to these directions.

Notes:

1. Where it is necessary actually to wind up the business, any agreement reached between the partners

should provide for a trustee to take charge of the settlement on behalf of the partners. The agreement should direct the closing up of the business, the liquidation of its assets, the collection of outstanding debts, the settlement of its obligations, the partition of losses or the division of profits, and the withdrawal of the investments of the partners.

2. Under no circumstances have the partners in an ordinary partnership the right to expel an objectionable member. The only way to get rid of such a partner is through a dissolution of the copartnership.
3. The legal enforced dissolution of a partnership is slow and costly and if possible should be avoided. Almost any agreed dissolution would be better.

§ 303. Winding Up the Business

Rights and Interests of Partners. Unless otherwise agreed, the amount of each partner's investment is returned to him in full on dissolution of the partnership, if there are sufficient assets. Any remainder, as profits of the business, is then divided in equal proportion among the partners. If losses have been incurred, the losses must first be apportioned equally among the partners, and the amount to be paid each on his investment account must be diminished by this amount.

If one or more partners are bought out, the business passes as a going concern into the hands of the remaining partners. If the partnership is dissolved by proceedings in equity or in bankruptcy, the receiver or trustee takes charge, and the partners turn over the assets to the receiver and have nothing further to do with the business other than to give such information as will aid him in his work.

If the partnership is incorporated, the corporation usually

succeeds to the assets, name, good-will, and location of the firm, and the business is continued as a going concern with the minimum of disturbance.

Duties of Partners on Dissolution. If the business is terminated by agreement, by limitation, or by the death, insanity, or insolvency of a partner, it is usually wound up by the surviving or liquidating partner or partners.

When surviving or liquidating partners take charge, it is their duty to notify people who have dealt with the firm of its dissolution and of the fact that they are engaged in winding up affairs. It is also the duty of these partners to dispose of and fulfil any existing contracts, to dispose of the partnership property to the best advantage, to discharge all debts and obligations, and to turn over to each person entitled thereto his due proportion of the surplus.

Right of Surviving Partner. In the case of the death or resignation of a partner, the surviving partner or partners have a right of possession for the purpose of settling up the affairs of the partnership, but after this is done the right of possession ceases, and each of the partners has the right only to his proportion of the partnership assets when converted into cash.

A surviving partner or partners would have power to sell property of the firm and do all other things necessary to wind up the business.

After the assets of the firm have been turned into cash and the debts have been paid, it is the duty of the surviving or liquidating partners, first, to repay any advances above the stipulated investment of capital to the partners who made them; next, if the funds permit, to return the capital of each partner. Any surplus is then divided among the partners in such proportion as the partnership agreement may provide, or, if there is no provision therefor, in equal proportion.

The surviving partner, if he continues the business, must

account for the value of the good-will of which the firm name is part.

Notes:

1. Surviving or liquidating partners have no power to bind the firm to new contracts or to undertake new business. Ordinarily they are not entitled to compensation for their services in settling the firm's affairs, unless the business is to be carried on for some time.
 2. The good-will of a business is often a most valuable asset. To secure compensation both for the good-will and the firm name, it is usually necessary to sell the business as a going concern.
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REVIEW QUESTIONS

1. In the absence of an express agreement, what is the rule for determining the duration of a partnership?
 2. How could a partnership be terminated by one of the partners before the time fixed in the articles?
 3. What happenings will terminate the partnership relation?
 4. Can a partner sell his interest in a firm, and if so, would the purchaser be a member of the firm?
 5. A, who is in partnership with B, desires to withdraw from the firm because of B's business methods. A offers to sell his share to B. The latter refuses to purchase. A then assigns his interest in the business to C, but B refuses to accept C as a partner. What are C's rights?
 6. What notice should a retiring partner give? Why?
 7. If a retiring partner agreed with those remaining that they should assume all debts, would that protect him as against existing creditors?
 8. Would the admission of a new member terminate the old partnership and create a new one in law? Need it have that effect in practice?
 9. When may a receiver be appointed?
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10. Why should an enforced dissolution be avoided? Suggest some better methods of winding up a partnership.
11. In winding up the affairs of a partnership: (1) What is the rule as to investments? (2) What is the rule as to profits? (3) What is the rule as to losses?
12. Is the capital of each partner necessarily the amount due him from the firm? In your state has a special partner prior right over the other partners in the distribution of the capital surplus?
13. In case of death of a partner, to whom does legal title to firm assets pass? Can a sole surviving partner sell property and give good title? Can a sole surviving partner make a general assignment without consent of representatives of deceased?

PART IX
CORPORATIONS

CHAPTER XLVIII

NATURE OF CORPORATIONS¹

§ 304. Corporate Entity

A corporation is an artificial person, created or authorized by the law for some particular purpose or purposes. It has, therefore, only those rights and powers which are given it by the law. These vary in the different states but are in all cases sufficient for the demands of ordinary business.

A corporation is usually composed of a number of persons associated together, though it may, and sometimes does, consist of but one or two members. These members, or stockholders, are not, however, the corporation. They compose it, but the corporation has a name, an entity, and an existence of its own, entirely apart and distinct from that of these members. Under its corporate name it may conduct business, make contracts, and bring suit. So absolutely different is the corporation's existence from that of its stockholders that it may enter into contracts with these latter, may sue them, or be sued by them.

305. Classification

A logical classification is that which separates all corporations into: (1) public and (2) private corporations.

Public corporations are those formed by the community for its own governmental purposes, as in cities, villages, and towns. These are also called municipal corporations.

All other corporations are private corporations.

Corporations formed to conduct public utilities, such as

¹ See Chapters CVI to CVIII, corporate forms.

railroads, turnpikes, and telegraph systems, or to supply water, gas, and electricity, if they are conducted for private gain, are properly classed as private corporations. They are sometimes called "quasi-public corporations" because they render services more or less essential to the public. More often they are termed "public utility corporations."

A moneyed corporation is one authorized to engage in the business of using money for the sake of making a profit upon it as money, such as banks, mortgage loan or trust companies, insurance companies, etc.

Corporations may also be classed as: (1) corporations sole, those consisting of a single person; and (2) corporations aggregate, those consisting of two or more persons.

Private corporations may be divided into corporations without capital stock and corporations with capital stock.

§ 306. Corporations Without Capital Stock

Most religious, educational, charitable (eleemosynary), and social organizations belong to this class. They are non-stock, or membership corporations. In some cases certificates of membership are issued to the members, but these are not stock certificates and are not usually transferable. When corporate action is taken, each member has one vote without regard to the amount of his financial interests, if any, in the corporation.

The body of modern corporation law has to do with the stock corporation.

§ 307. Corporations With Capital Stock

Stock corporations have a capital stock divided into shares, usually of like amount, which are evidenced by transferable certificates of stock. These stock certificates are issued to the members of the corporation, who are termed stockholders, the certificates evidencing the number of shares which each owns.

The ultimate control of the corporation rests with the stockholders, who act in meetings and by vote. Each share of stock usually entitles its owner to one vote in stockholders' meetings, hence those owning a majority of the shares control the corporation. When profits are to be divided, they are distributed among the stockholders in proportion to the number of shares owned by each.

On account of the convenience of the system, all corporations intended for profit are organized as stock corporations.

§ 308. Distinctive Features

The distinctive features of a modern stock corporation may be summarized as follows:

1. Its creation and regulation by the state.
2. The limitation of the corporate powers to the objects specified at the time of its creation, or later by amendment.
3. The limitation of the liabilities of the stockholders.
4. The distinct entity of the corporation for all legal and business purposes.
5. The comparative permanence of its organization.
6. The representation of the interests of the stockholders in the corporation by transferable shares of stock.
7. The corporate mechanism of directors, officers, and agents, working under definite rules of action.

These features are possessed by every stock corporation, and every organization possessing them is a stock corporation.

§ 309. (1) Creation by the State

A partnership may be formed by the mere agreement of the parties. A corporation, on the contrary, may be created only by the state. Formerly each corporation was created by a separate legislative enactment. Today the formation of

corporations is governed by general laws. These laws vary in minor details in the different states. All are alike in their general plan and scope. In each state, the legal requisites are to be found in the state law.

§ 310. (2) Limited Powers

An individual or a partnership may engage in any business that seems best, and may change from one business to another at pleasure. A corporation, on the contrary, is limited to those purposes enumerated in its charter. If it is desired to engage in any other business, it must amend its charter.

§ 311. (3) Limited Liability

Subscribers to the stock of a corporation are liable to the corporation for their subscriptions. Calls for payment on unpaid stock must be impartial and uniform, that is to say, calls must be made on all subscribers alike. If the subscriptions have not been paid, the corporation, or its creditors in case of its insolvency, can compel payment. A subscriber cannot repudiate his subscription. If subscriptions have been accepted by the corporation at less than par, corporate creditors can usually force payment of such additional amounts as will render the stock full-paid. (See §353.)

A subscriber to stock who fails to make his payments is chargeable with interest from the time he makes default. He must pay both principal and accrued interest before he can claim a negotiable certificate of stock.²

A subscriber to stock, being sued for payment, and claiming that he was induced to subscribe through fraud, must show that the agent was duly authorized by the corporation, that his statements were in fact of the condition of the corporation in past or present time and that his representations did materially influence the subscriber to take the stock.

² Cook on Corporations, 112.

Beyond this liability, known as the subscription liability, stockholders have in most states no individual liability for any indebtedness of the corporation.

§ 312. (4) Legal Entity of Corporation

The distinct legal entity of the corporation may best be shown by a comparison between corporations and partnerships. The difference is radical.

A partnership is merely a collection of all the individual partners. Hence each partner represents the partnership fully, can make contracts for it without consultation with other partners, and can bind it by his action. On the other hand, he cannot contract with his partnership, bring suit against it, or be sued by it, any more than he could so act with or against himself. In any suit by or against a partnership each partner must be named.

A corporation, on the contrary, is itself a legal entity, distinct from its stockholders. These stockholders as individuals do not represent it, cannot make contracts for it, nor bind it in any way. Each may, however, deal with the corporation as with a stranger, may contract with it, may sue it, may be sued by it. A corporation sues or may be sued by its corporate name and the members' or stockholders' names do not appear.

§ 313. (5) Permanence

A partnership may be dissolved at any time, at the will of any partner, and is necessarily dissolved if a partner dies, becomes insolvent, or sells out to a stranger. A corporation, on the contrary, continues for the term of its existence, uninterrupted by the dissatisfaction, financial embarrassment, death, or retirement of its stockholders. Its entire membership may change again and again, but the corporation continues.

§ 314. (6) Stock System

The division of the stock of the corporation into shares represented by stock certificates, transferable by indorsement, is one of the most convenient features of the modern corporate system. It permits the investment of varying amounts, and gives each investor his proper proportionate interest both in the management and in the resulting profits of the business. It permits a ready sale of part or all of the stockholder's interest to some other investor. In case of his death it renders the transfer or division of his interest a simple matter. It is in striking contrast to the difficulty of transferring an interest in an ordinary partnership.

§ 315. (7) Corporate Mechanism

A corporation is created by the grant of a charter from the state, which in general terms defines the rights and powers of the corporation. After this charter has been allowed, the incorporators hold a meeting and adopt by-laws which lay down the lines along which the business of the corporation is to be conducted. The stockholders elect a board of directors, which, subject to the regulations of the charter and by-laws, controls and manages the business and property of the corporation.

The directors at their first meeting elect officers and take such other action as may be necessary to inaugurate the corporate activities. Thereafter they hold their meetings from time to time as may be required by the by-laws or the necessities of the business.

§ 316. Attractiveness to Investors

As a consequence of the advantages enumerated, and because of the liabilities and inconveniences of the partnership, the corporate form is peculiarly attractive to the investing

public. Created by the state for a fixed period, it is not liable to sudden or unexpected termination. The rights and liabilities of all concerned are defined by law and well settled by custom. It permits investment to a definite extent without indefinite or continuing liability and without the necessity of the investor becoming identified with the management.

§ 317. Disadvantages of the Corporate Form

The disadvantages of incorporation result from the fact that special reports and special taxes are required of corporations, above those required of sole traders or partnerships.

Most states require reports as follows:

1. Local tax reports.
2. State tax reports.
3. Federal tax reports.
4. Annual reports of officers, etc.
5. Reports in each state outside the home state in which the corporation does business.

The taxes paid by corporations at various times are as follows:

1. Organization taxes payable to the state for incorporation.
2. Annual franchise taxes paid to the state under the laws of which it was incorporated.
3. Annual taxes on property.
4. Federal income and excess profits taxes.
5. Inheritance taxes on stock.
6. Stock-transfer tax.
7. Taxes and license fees in each state outside the home state in which the corporation does business.
8. Excise taxes.

REVIEW QUESTIONS

1. What is a corporation? Distinguish a corporation from its membership.
2. Distinguish between public and private corporations. What are public utility corporations? What is a moneyed or financial corporation?
3. Distinguish between stock and non-stock corporations. To which class do all business corporations belong?
4. What are shares of stock? What are stock certificates?
5. What is a moneyed corporation? What is a corporation sole? What is a corporation aggregate?
6. What are the seven distinctive features of a modern stock corporation?
7. How is a corporation formed in your state, and what are the legal requisites for incorporation?
8. What is the difference between the powers of a corporation and the powers of a partnership as to what business it engages in?
9. In case a corporation is insolvent, to what extent are subscribers liable? What remedies has a corporation on an unpaid subscription to capital stock?
10. What is meant by "the distinct legal entity" of the corporation? How does a partnership sue? How does a corporation sue?
11. Why is a corporation more permanent than a partnership?
12. How can an interest in a corporation be transferred? How can an interest in a partnership be transferred?
13. Explain the stock system.
14. What is meant by the corporate mechanism?
15. Why is the corporation form attractive to investors? Why is the corporate form used for most large business enterprises?
16. What disadvantages attach to the corporate form?

CHAPTER XLIX

THE CHARTER¹

§ 318. Definition—Synonyms

The terms, certificate of incorporation, articles of association, etc., are synonymous with the older and briefer word, charter. A charter is the formal authority from the state for the existence of a corporation. It is to the corporation what a constitution is to a civil government. It is the foundation upon which the corporate structure is built.

The charter creates the corporation and authorizes certain specified individuals to organize it and conduct its operations. Charters were formerly granted only by special legislative enactment. Now they may be secured under general laws and in many states can be secured in no other way.

Charters are granted under different statutes varying in terms and requirements according to the purposes of the corporation. The simplest charter is usually that provided for a manufacturing or mercantile business. The requirements and limitations for the charter for a bank, a railroad, a telegraph company, or a college would differ widely.

§ 319. Charter Powers—General

The grant of a charter bestows upon a corporation all the powers properly specified in the application for a charter. In addition to these specified powers—which are usually those necessary to conduct the business or enterprise to be undertaken by the corporation—the charter confers certain general

¹ See also Chapter L. For form of charter, see Chapter CVI, Form 54.

powers, whether specified or otherwise. These general powers are as follows:

1. To sue and be sued.
2. To use a seal.
3. To buy, sell, and hold property.
4. To appoint directors, officers, and agents.
5. To make by-laws.
6. To dissolve itself.
7. To do all things necessary.

These are discussed in order in the following sections:

§ 320. (1) To Sue and Be Sued

When a partnership is sued each partner must be named separately and be made a party to the action. A corporation may sue or be sued under its corporate name just as may an individual. No mention need be made of its stockholders. A summons may be served on any managing officer, on any director, or on an agent in charge of the corporate affairs.

§ 321. (2) To Use a Seal

Formerly the seal was the essential feature of the corporate signature. Now the corporate signature may be affixed by any properly authorized agent without the use of the seal, save in those cases where even an individual must use a seal, as in the conveyance of real estate or the execution of a bond.

The custody of the seal usually rests with the secretary of the corporation.

§ 322. (3) To Buy, Sell, and Hold Property

This power must be taken with some qualifications. The property must be such as pertains to the business of the corporation and such as it is permitted to hold under the laws. In some states the ownership of land by corporations is re-

stricted. Also in many states a corporation may not hold shares of stock in another corporation. A corporation must dispose of property taken for debt, if it has no charter right to hold that kind of property.

§ 323. (4) To Appoint Directors, Officers, and Agents

This power is absolutely necessary as the corporation can act only through such representatives. The stockholders at their annual meeting elect directors who have charge of and manage the corporate affairs. These directors then meet and elect a president, a treasurer, a secretary, and such other officers as may be desired. Agents may be appointed by the directors or by the officers, when authorized thereto.

§ 324. (5) To Make By-Laws

The by-laws are adopted by the stockholders. They are the working rules of the corporation and provide for the details of its operation. The by-laws are subordinate to the laws of the state and to the charter of the corporation, and their provisions must not be inconsistent with either. Under this limitation, however, the by-laws have wide scope.

§ 325. (6) To Dissolve Itself

When a corporation has failed in its object, or has become unprofitable, or has completed its intended purpose, or has disposed of its business and property, its dissolution may become desirable. Formerly the unanimous consent of all the stockholders was generally required for dissolution. Now in most states some specified majority of the stockholders by simple statutory proceedings may dissolve the corporation. In such case the assets are sold, and, after payment of any corporate debts, any remaining funds are divided pro rata among the stockholders.

§ 326. (7) To Do All Things Necessary

A corporation organized for some specified purpose has the legal right to make all contracts and do all proper things necessary to carry out that purpose. For instance, a corporation organized to build and operate a factory would without special authorization thereto have the right to buy and hold the real estate required for the erection of its plant.

§ 327. Charter Powers—Special

The special powers of a corporation are those specifically mentioned in its charter which, if not so mentioned, it would not possess. The usual purposes for which corporations are formed, with their amplifications, are included among these, but in most states the law allows many further powers that add much to the value of the corporate system.

Among these may be mentioned provisions as to the issue of preferred and other special stocks, the system of cumulative voting, the power to hold stock of other corporations, etc. Also restrictions of various kinds may be embodied in the charter, such as limitations on salaries to be paid officers, or restrictions on the power to mortgage the corporate property or to contract indebtedness generally.

§ 328. Things Ultra Vires

An individual or firm may do anything not forbidden by the law. A corporation may do only those things expressly permitted to it under the law. All other things are beyond its powers, or in legal parlance, *ultra vires*. Contracts not yet carried out by the other party, involving matters *ultra vires*, cannot be enforced by the corporation; but if these other parties to a contract have performed their part, the contract may be enforced against the corporation—that is, a corporation cannot evade its obligations by the plea of *ultra vires*. Directors and officers may make themselves personally liable

either to the corporation, to its stockholders, or to third persons, if they involve the corporation in transactions of this nature.

§ 329. Amendment of Charter

Any corporate right or privilege that might have been secured in the original charter of a corporation may, in most of the states, be secured by charter amendment, and such amendment may be made at any time, even before the organization of the corporation is completed.

As a preliminary step, amendments of the charter usually require the assent of at least two-thirds of the outstanding stock of the corporation in the manner prescribed by law—usually by vote at a regularly called meeting. The amendment so authorized is then as a rule filed in the same offices and with the same formalities as the original charter, becoming effective as soon as allowed and filed.

REVIEW QUESTIONS

1. What is the basic agreement that forms a corporation? Who are the parties to it? Give different kinds of charters.
2. What are the usual corporate powers? Give examples.
3. What are special charter powers?
4. What are things *ultra vires*? What is the effect if a corporation exceeds its powers?
5. Distinguish between acts of directors resulting in personal liability and such as are merely *ultra vires*.
6. The president of a corporation in your state went to a bank in Chicago and requested the loan on his note of \$10,000 for his personal benefit. The bank president said that he would make the loan if the directors of the borrower's company would authorize the borrower to indorse it in the name of the company. They did so, the indorsement was made, the bank discounted the note, and paid the proceeds to the maker. He failed to pay it; proper demand was made and notice

of non-payment given. Is the indorsement binding on the company? Give reasons for your answer.

7. What is the procedure for amending a charter in your state?
8. If a corporation to secure a debt took property that its charter did not authorize it to hold, what should it do?
9. If suit were brought against a corporation, upon whom would the papers be served?
10. By whom are directors elected? Who choose the executive officers?
11. Could a railroad company operate a telegraph line?
12. If a corporation issues stock in excess of its authorization, is the excess stock valid?

CHAPTER L

INCORPORATION¹

§ 330. Application for Incorporation

In former days a grant of a special charter would be made to specified persons, authorizing them to conduct some particular enterprise under the corporate form. Usually these charters conferred some franchise or special privilege, as the right to erect a toll bridge, establish a bank, construct a railroad, or build a dam.

The abuses arising from this method of granting charters have resulted in most states in the establishment of general laws under which corporations may be formed for any legitimate purposes, by any qualified persons upon compliance with prescribed formalities. In some few states special charters are still granted on occasion.

The form of application for a charter under these general laws is usually merely a copy of the charter desired.

It may be called a "certificate of incorporation," "articles of association," or other similar name. It sets forth the names of the applicants and the name, purposes, and other required details of the projected corporation. It usually also includes the proposed capital, the par value of the shares, the principal office of the corporation, its duration, the number and names of its first directors, the subscribers to its stock and any special provisions that are desired. The charter application when allowed becomes itself the charter.

It is executed by the incorporators, and, after its allowance by the Secretary of State, is filed in his office. It must also

¹ For incorporation forms, see Chapter CVI, Forms 53, 57.

usually be filed in the office of the clerk of the county in which the corporation is domiciled or has its home. If the proposed corporation is for proper purposes, if all fees have been paid, and the application is in due form, it is accepted and filed as a matter of course and the incorporation is accomplished.

The details of incorporation as given are the simple forms used for ordinary business corporations. The formalities and requirements for organizing a public utility corporation are more complex and more onerous.

§ 331. Incorporators

The parties applying for a charter must be competent persons of full age, and ordinarily some proportion of them must be citizens of the state in which the application for charter is filed. Minors, firms, or corporations, and generally persons not able to contract, are not competent parties, though they may usually hold stock after the corporation is formed. Persons acting in a representative capacity cannot act as such in incorporating a company. The minimum number of applicants is in most states three, though in some few states five are required. Each incorporator must ordinarily subscribe for one or more shares of stock and all must sign and acknowledge the application.

§ 332. Name of Corporation

Names like, or nearly like, those of corporations already rightfully doing business in the particular state may not be selected as the corporate name. In some states all corporate names must begin with "The" and end with "Company." In others the name must be followed by "Limited" or "Incorporated." In many states, firms may become incorporated under the partnership name without change or addition of any kind.

§ 333. Purposes

The purposes for which a corporation is to be formed must be set forth in the application. They must be permitted by the laws of the particular state. Ordinary business corporations are allowed much latitude in stating their purposes and are not usually confined to one business or line of activity. (See Chapter LI.)

§ 334. Capitalization

The capital stock of the proposed corporation must be specified in the application and may be changed thereafter only by amendment of the charter. (See § 349.)

§ 335. Shares

In most states of the Union the par value of shares of stock may be fixed by the incorporators at discretion. In some few states there are general restrictions, as in New York where the par value of the share must be not less than \$5 nor more than \$100. In New York and some other states shares may also be issued without any par value.

One hundred dollars is the most convenient and most generally adopted par value for shares of stock. (See § 349.)

§ 336. Location

A corporation must have its principal office in the state in which it is incorporated. The location must usually be specified in the application for its charter.

In the state of its incorporation the company is a "domestic" corporation. Elsewhere it is a "foreign" corporation. In its own state it has certain legal rights as an incident of incorporation. In other states it has no such rights except as a matter of courtesy or as may be granted there by legislation.

§ 337. Duration

In some states the duration of corporations is limited to some fixed maximum as twenty, thirty, or fifty years. In most states, however, while a corporation may be limited to any term specified by its charter, it is permissible to make its duration perpetual.

§ 338. Number of Directors

The number of directors of the corporation must in most states be specified in the charter application. The minimum allowed by law is usually three. (See § 371.)

§ 339. Classification of Stock

Under the laws of most of the states, stock may be classified in various ways. The customary classification is into common and preferred stock. Another frequent classification is that of voting and non-voting stock. Sometimes stock is classified so that each class of stock elects one or more directors. (See § 356.)

§ 340. Cumulative Voting

The cumulative system (see § 367) is employed only in the election of directors.

§ 341. Execution of Certificate

The charter application, having been duly made out in conformity with the laws of the state of incorporation, is signed, usually in duplicate, by the incorporators. It is then acknowledged before some officer authorized to take acknowledgments to deeds, and is ready for filing.

§ 342. Filing and Recording

Under the usual procedure, the duly executed application, accompanied by the proper fees, is sent to the office of the

Secretary of State, while another copy is filed with the county clerk of the county in which the proposed corporation is to have its principal office. Each state has its own minor variations in procedure, which will be found in its statute law.

In New York the state fees must be sent to the State Treasurer. When these fees are received, the Treasurer certifies that fact to the Secretary of State, who will not file the charter until this certification is received. In New Jersey the application is filed with the county clerk first, and a copy certified by him is then filed with the Secretary of State. In some states, the application must receive the approval of the judge of a specified court before it will be filed.

If the application for charter is in due shape and all fees are paid, it is accepted and filed as a matter of course. The application becomes, when filed, the charter of the corporation. The existence of the corporation dates from such filing.

As the procedure for incorporation varies in each state, it is best to study the statutes and the forms prescribed in the reader's own state. In most states these statutes are published in a pamphlet and the blank forms are usually sent out on application to the Secretary of State.

§ 343. De Facto Corporation

Sometimes an attempted incorporation may fail and then a question may arise as to the liability of the members. The elements of a *de facto* corporation are:

1. A general law under which the corporation could be legally formed.
2. A bona fide attempt to comply with the provisions of that law.
3. The exercise of corporate powers.

When these elements exist the liability of members will be the same as if the incorporation had not been defective.

Otherwise the members will be liable as partners. In some states the doctrine of *de facto* corporations is not recognized.

§ 344. Contracts Prior to Incorporation

When contracts are entered into in expectation of the formation of a corporation and on its behalf, the status of the trustees or parties in charge, if the corporation fails of incorporation, depends upon the nature and condition of the contract. A subscription to stock would be terminated, and if payment had been made thereon to a trustee, any unexpended amount might be reclaimed; and if the trustee were to blame for the failure to incorporate, he might be responsible for the portion expended as well.

Other contracts, if clearly made on behalf of the proposed corporation, would in most cases be terminated. If not clearly made for the new corporation, the parties contracting for the corporation might be held to specific performance or for damages for non-performance. (See § 146.)

If the incorporation proceeds without misadventure, such contracts would be ratified and adopted by the new corporation. The promoters usually control the first meetings and look out for this. If the company without formal adoption took advantage of a contract, or used services contracted for by promoters, it would be liable for a fair compensation.

REVIEW QUESTIONS

1. What is the usual procedure in incorporating a company in your state? Prepare the required application for charter of a manufacturing corporation.
2. May persons acting in a representative capacity be incorporated? Can a corporation be a party to an incorporation?
3. Where must the principal office of a corporation be? How is it fixed?
4. How may stock be classified?

5. How is the application for a charter executed? Where is it filed in your state?
6. What is a *de facto* corporation?
7. How many incorporators are required in your state to organize a business or a manufacturing corporation?
8. Why are shares without par value desired?
9. The promoters of a company before its incorporation employ an accountant to prepare the prospectus, which the company makes use of. May he recover for his services against the company?
10. When persons associate themselves together as a corporation and the corporation is defective or incomplete, what is their position as against the creditors of the corporation?
11. What is the distinction between foreign and domestic corporations?

CHAPTER LI

BY-LAWS¹

§ 345. Definition

By-laws are the more permanent rules of corporate action as distinguished from motions and resolutions, which usually apply only to particular occasions and special matters.

A corporation is controlled: (1) by the corporation laws of the state in which it is domiciled, (2) by the provisions of its charter, and (3) by its by-laws, these three ranking in the order given as to authority. Hence any by-law that does not accord with the statutes of the state and also with the provisions of the charter of the particular corporation is void.

By-laws are enacted by the stockholders and by them alone, unless, by statute, by charter provision, or by action of the stockholders themselves, such power has been delegated entirely or in part to the directors of the corporation.

By-laws limiting the power of officers to make contracts will not be effective against one who contracts with the corporation without knowledge of those by-laws. The officers, though, would make themselves liable to the corporation for any damage resulting from their breach of duty.

§ 346. Adoption

A corporation is not compelled to adopt by-laws. Its operation without them would, however, be practically impossible.

A reasonably complete set of by-laws is usually adopted by the stockholders at their first meeting, and these by-laws

¹For form of by-laws, see Chapter CVI, Form 55.

are added to, amended, or repealed from time to time thereafter as may be necessary.

By-laws should be carefully drawn, properly adopted, and accurately recorded in the minute book of the corporation. They should provide fully for all the important details of corporate procedure, such as the issuance and transfer of stock, the meetings of the stockholders and directors, the election of directors and officers, the respective duties and responsibilities devolving upon these, and the care and management of the corporate property and finance. They should also include the more important provisions of the charter and of the statute law as far as applicable. This is done in order to provide a convenient and accessible memorandum of these provisions. Without this they might be overlooked or forgotten.

§ 347. Amendment

The by-laws usually prescribe the method of their own repeal or amendment. Unless otherwise provided by statute, charter, or by proper provision in the by-laws themselves, these by-laws may always be repealed or amended, either in whole or in part, by a majority vote of a quorum of stockholders at any regular meeting, or at any special meeting duly called for that purpose. The directors have no power to repeal or amend by-laws under any circumstances unless such power is expressly given them by the laws of the state of incorporation, by the charter of the corporation, or by its by-laws.

§ 348. Enforcement

Direct penalties for the violation or non-observance of by-laws are sometimes provided. These usually take the form of fines. Such penalties are, as a rule, unsatisfactory and very difficult of enforcement. The smaller infractions are usually passed over, or recurrence is prevented by the substitution of

more reliable officials at the next election. The more serious violations bring their own penalties in the legal liabilities and entanglements that necessarily follow. Corporate action taken in disregard of by-law provisions is, for that reason, not only illegal but may at times involve the directors and officers concerned in personal liabilities.

REVIEW QUESTIONS

1. What are by-laws? How do by-laws rank as compared with other corporate regulations? Are by-laws binding on people who do business with corporations? Give reasons for answer.
2. Who adopt or amend by-laws in your state? If a corporation adopted a set of by-laws which provided that any amendment required a two-thirds vote, would a subsequent amendment by a majority be good? Give reason for answer.
3. How are by-laws enforced?

CHAPTER LII

STOCK¹

§ 349. Capital Stock

The capitalization or capital stock of a corporation is the amount of stock as fixed by its charter which the corporation is empowered to issue. This amount can be changed only by amendment of the charter. This capital stock is regarded as divided into equal shares, termed "shares of stock." When by purchase or otherwise a person acquires an interest in the capital stock, he becomes a stockholder in the corporation, and his interest is expressed in these shares of stock.

The par or face value of shares of stock is fixed by the charter of the particular corporation, and, unless expressly limited by statute, may be placed at any amount desired by the incorporators. This par value can be changed only by charter amendment. One hundred dollars is the most common par value of shares. The number of shares owned by any individual gives an accurate measure of his interest in the corporation. For instance, if a man owns ten shares of the par value of \$100 each in a corporation with a capitalization of \$10,000, all of which is issued, he owns a total stock interest of one-tenth of the entire outstanding capital stock, and therefore has an undivided one-tenth interest in the entire corporate property and business.

The par value and the actual value of a share of stock may be very different. A hundred-dollar share of stock in a prosperous corporation will frequently be worth several times

¹ For form of subscription list, stock certificate, and assignment of stock certificate, see Chapter CVI, Forms 53, 57.

that amount, while in an unsuccessful corporation it may be worth little or nothing. In either case the par value remains the same.

§ 350. Stock Certificates

Stock certificates are issued as a convenient evidence of the stockholders' interests in a corporation, and every stockholder whose stock is paid for has a right to such a certificate. These certificates state the number of shares owned, their par value, and usually any other material facts affecting the stock in question, as, for instance, that it is full-paid, or that it is preferred stock. These certificates of stock are signed by the president and the secretary, or the president and the treasurer of the corporation and are sealed with the corporate seal. When properly issued, they are conclusive evidence of the ownership of the stock represented by them.

The stock certificate, as already stated, is merely the evidence of ownership of stock and is not the stock itself. The stock of a corporation usually exists before stock certificates are issued at all, and may be bought and sold by proper entries on the corporate books.

Old stockholders have a right to purchase new stock pro rata before it may be offered to outside investors. However, a price may be fixed, not less than par, and if the stockholders are given an opportunity to take stock at that price in proportion to their holdings, and the offer is not accepted, the right is lost, and the stock may be sold to others, at the advanced price. In some cases subscription scrip that can be sold to others is issued to stockholders in proportion to their holdings.

Each share of stock usually entitles the owner of record to one vote in all proceedings of the stockholders, whether assembled in annual or special meeting. In most states, by proper charter provision the voting power of stock may be restricted, or stock may be issued without voting power. Pre-

ferred stock is very frequently so issued. Unless expressly denied or restricted by proper provision, all stock has the usual voting power and this right may be exercised by the owner of record in person, or, usually, by proxy.

§ 351. Capital Stock vs. Capital

The "capital stock" or capitalization of a corporation should be very clearly distinguished from its "capital."

The capital stock is the total amount of stock the corporation is authorized by its charter to issue. This amount is fixed in the first place by the parties organizing the corporation—who are termed the incorporators—and, once accepted and authorized by the state, may be changed only by formal amendment of the charter.

The capital, on the other hand, is the net actual amount of property owned by the corporation, that is, the excess of its assets over its liabilities. It is obvious that the value of these assets is liable to change with the fluctuations of the business or from other causes. The capital stock of the corporation and its capital, therefore, even though equal at first, may and frequently do differ greatly in amount. For instance, the capital stock of the Chemical Bank of New York City is \$3,000,000 while its capital is over \$7,500,000.

§ 352. Unissued and Issued Stock

Unissued stock is not an asset of the company but is merely an unexercised right to issue stock when and as subscriptions for it are accepted.

It usually represents excess capitalization. For instance, a corporation organized to take over property worth \$20,000 might perhaps be capitalized at \$25,000 with the idea of selling the excess stock at some future time to raise working capital.

Issued and outstanding stock is stock which has been issued for cash, property, labor, services, or other values, or which

has been subscribed for and the subscriptions accepted by the company. Such stock is issued stock and the subscribers or purchasers are stockholders of the company, even though the actual certificates by which this stock is represented may not have been issued.

Section 55 of the Stock Corporation Law in New York State provides that:

No corporation shall issue either stock or bonds except for money, labor done, or property actually received for the use and lawful purposes of such corporation.

§ 353. Full-Paid Stock

In most of the states, payment for stock may be made in anything of value. If the corporation has received the full face value for issued stock in cash or in any other form of payment permitted by law, such stock is termed full-paid, and its certificates should be marked "Full-Paid" in order to indicate this fact. After stock has once been issued for full value, it may be sold at less than par without involving the purchaser in any liability for the difference.

If the corporation has not received the full face value for issued stock, the stock is but partly paid, and the immediate purchaser of, or subscriber to, such stock may usually be held liable for the amount necessary to render it full-paid. This liability may be enforced either by the corporation, or, in event of its insolvency, by any creditor of the corporation.

Stock certificates issued as full-paid when they are not full-paid will not protect stockholders, who knowingly subscribe for or buy such stock, from liability to creditors in case of insolvency. But an innocent purchaser for value who buys in the open market is not liable either to the corporation or its creditors.

Watered stock is stock for which the corporation has not

received full payment in cash, services, or property. Watered stock is usually created by the issuance of stock in payment for property or services which have been overvalued; sometimes also it is created by the issue of stock insufficiently supported by the corporate property, as for instance, in cases of unwarranted stock dividends.

§ 354. No Par Value Stock

In some states, as in New York, stock may be issued having no par value. Its value is the market rate. Here the stock is full-paid when it is sold at whatever can be obtained for it in the market, and there is no further liability.

§ 355. Common Stock

Common stock is the general or ordinary stock of a corporation, with neither special privileges nor restrictions. If any portion of the stock is given special privileges or restrictions, that portion is thereby removed from the class of common stock and the remainder constitutes common stock. Any statements made concerning stock, when the class is not specified, are usually understood to apply to the common stock.

Non-participating stock is stock sharing in all dividends but giving the owner no voting right.

§ 356. Preferred Stock

Preferred stock, as the term is usually employed, is that which has some preference as to dividends or assets over other stock of the same corporation. This preference is usually secured to it by special provisions in the certificate of incorporation, though in some states this may be attained by by-law provision.

Preferred stock may be either cumulative or non-cumulative as to dividends. Non-cumulative preferred stock must

receive its preferred dividend for the current year before any dividend is paid the common stock, but if in any year its dividend fails or is only partly paid it loses the unpaid amount. If the dividends on cumulative preferred stock are not paid in any year, or years, or are but partially paid, the amounts unpaid go over, or cumulate, and must be satisfied before the common stock receives anything. They remain a charge against the profits of the company until paid in full.

It is usually provided that preferred dividends shall be paid in full before the common stock receives any dividend. Unless otherwise expressly provided, after the preferred dividends are paid in any year, the common stock receives an equal dividend if the profits are sufficient, and both kinds of stock then share alike in any further dividends declared in that year. It is sometimes provided that, after the preference dividends are paid, the preferred stock shall share equally in all further profits with the common stock. Preferred stock is sometimes limited to its preferred dividend and does not participate at all in any further dividends.

It is often provided that in case of dissolution preferred stock shall be satisfied out of any assets of the company before the common stock receives anything. If this provision is not made, either by statute or by charter, the preferred stock in any liquidation of the corporation will first receive any dividends then due, but thereafter will fare the same as common stock.

Preferred dividends may be paid only from profits. If there are no profits, or if the profits are needed for purposes of the business, the dividends to preferred stock are either passed entirely or cumulated until profits are made. Unlike a bond, preferred stock is not a debt or liability of the corporation. Its owners are stockholders and not creditors, and failure of dividends gives no cause of action against the company or its directors.

§ 357. Treasury Stock

Treasury stock, in the better use of the term, is stock which has been issued for value and has by gift or purchase come back into the possession of the company. It differs from unissued stock in the fact that it may be sold below par without involving the purchaser in any liability for the unpaid balance. So long as the treasury stock is held by the company, it can neither vote nor draw dividends.

§ 358. Lost Certificates

A stockholder's rights are not affected by the loss or destruction of his stock certificate. Its absence may involve much inconvenience, more particularly if the stock is to be sold. The directors may, in their discretion, provide for the issue of a duplicate subject to the by-laws, which usually provide that a bond must be required.

If a certificate is lost the secretary of the company should be notified promptly, as otherwise the stock certificate might be presented under circumstances which would justify him in making any desired transfer. After notification he would make such a transfer only by direction of the board.

§ 359. How Transferred

Stock certificates usually have a blank form of transfer printed on the back. If this is simply signed, the stock may be transferred to anyone, and he will have a right to obtain a certificate made out to himself by surrendering the indorsed certificate to the corporation. If the name of the person to whom it is transferred is inserted, only that person has a right to the stock and to the new certificate.

A Uniform Stock Transfer Act is now in force in fourteen states and territories and governs the method of transferring stock and the rights of transferee and transferor. The states which have accepted this act are:

Connecticut	New York
Illinois	Ohio
Louisiana	Pennsylvania
Maryland	Rhode Island
Massachusetts	Tennessee
Michigan	Wisconsin
New Jersey	
and the territory of Alaska	

REVIEW QUESTIONS

1. What determines the amount of stock a corporation may issue? What is the par value of stock? What is the actual value? What fixes the actual value?
2. What is a stock certificate? If a "close" corporation, that is, a corporation with a small harmonious group of stockholders, decided not to issue certificates, what would be the effect?
3. When the capital of a corporation is increased, what persons have a prior right to subscribe for the new stock, and in what proportions? May such right be made negotiable, and if so, how?
4. What is the difference between the "capital stock" and the "capital" of a corporation?
5. For what kinds of property may a corporation under the laws of your state issue its capital stock in payment? Explain fully. How are directors liable if they allow subscribers to stock to pay some instalments with notes?
6. Stock certificates are issued to the original subscribers bearing the printed words "fully paid and non-assessable," when in fact they were only partly paid for; later the stock is sold and assigned to a purchaser without notice of the fact that it is not paid for in full. What remedy has a creditor or the corporation against the original subscriber and against the transferee?
7. What is the object of "no par value stock"?
8. What is common stock? Define non-participating stock. What is preferred stock? Is preferred stock a debt of the corpora-

tion? Why do investors object to non-cumulative preferred stock?

9. Have preferred shareholders a right to recover when dividend is earned but not declared? In event of insolvency can a holder of preferred stock claim payment for par value before creditors?
10. Which is the safer investment, preferred or common stock? Why?
11. Why is common stock sometimes more valuable than preferred stock?
12. What is treasury stock? How does it differ from unissued stock?
13. If a stock certificate is lost, what should be done?
14. How is stock transferred?

CHAPTER LIII

STOCKHOLDERS AND THEIR MEETINGS¹

§ 360. Incorporators

Incorporators are the persons who sign the certificate of incorporation. They must usually be subscribers for stock and later become stockholders. It is the incorporators who draw up the application and make the charter provisions. After the charter has been accepted, those who have subscribed for stock become stockholders and these elect the directors. (See § 331.)

§ 361. What Constitutes a Stockholder

The stockholders of a corporation are those who actually hold its stock, or who have subscribed for its stock and have had their subscriptions duly accepted by the corporation. A "stockholder of record" is one whose ownership of stock is duly recorded upon the books of the corporation.

When outstanding stock is purchased, the transfer must be entered on the books of the company before the purchaser becomes a stockholder of record, entitled to vote, to share in dividends, and to receive a certificate of stock in his own name. Until that time he is the equitable owner of the stock, but is not known or recognized in any way as a stockholder.

§ 362. Rights of Stockholders

The individual stockholder has but little part in the active management of the corporation.

The rights of holders of common stock may be stated as follows:

¹ For form of minutes of stockholders' meetings, see Chapter CVII, Form 99.

1. To be notified of, and to participate in, all stockholders' meetings, in person or by proxy, and to cast one vote for each share of stock held.
2. To vote in the election of directors at the annual meeting each year, and upon any amendment of the by-laws or other general matters brought before the meeting.
3. To share, in proportion to the amount of stock owned, in all dividends declared on the common stock.
4. In event of the dissolution of the corporation, to share in like proportion in any assets remaining after all the corporate debts and obligations have been paid.
5. To inspect the corporate books and accounts.

It should be said, however, that this last right has been so restricted in practice as to amount to little more than the right to inspect the list of holders of stock as shown by the stock ledger.

The remedy of a stockholder denied access to the books would be by writ of mandamus. Theoretically, the holder of a single share may enforce this right of inspection, but practically the courts would hesitate to act where the interest was small. To inspect the books of a large corporation is a serious interference with business and the courts would not allow inspection except for weighty reasons.

Holders of preferred stock have the same rights, except as these may have been extended or restricted by the conditions under which the stock was issued.

§ 363. Powers of Stockholders

The powers of the stockholders may be summarized as follows:

1. Adoption or amendment of by-laws.
2. Election of directors.
3. Amendment of the charter. (See § 329.)
4. Dissolution of the company.
5. Sale of the entire assets of the company.
6. The exercise of any specially conferred charter powers.

The board of directors is the sole managing and controlling authority of the corporation. The stockholders make the by-laws by which the directors are controlled, and elect the directors by whom the corporate affairs are conducted, but beyond this they do not interfere in any way with the transaction of the corporate business or the management of the corporate property. All this rests with the board. Nor can the stockholders act directly for the corporation. A contract signed by every stockholder would not be the contract of the corporation and would not bind the corporation, unless also signed by its proper officers or otherwise formally accepted by its directors.

§ 364. Liabilities of Stockholders

A stockholder is liable to the company or to its creditors for any instalments remaining unpaid upon stock subscribed for by him. He may also be liable to creditors on any stock held by him which is not full-paid. Should dividends be paid from capital instead of from profits, stockholders are liable to corporate creditors for any amount so received by them.

Also stockholders of national banks and of most state banks and trust companies are held liable in case of the insolvency of their institutions, for an amount equal to their original subscriptions.

As a rule, however, in the ordinary business corporation the holder of full-paid stock is in no danger of losing anything more through corporate failure or insolvency than the amount he has actually invested in his stock.

§ 365. Stockholders' Meetings

The annual meeting is usually the only regular meeting of stockholders. It must be held in the state in which the company is incorporated, unless the laws of such state expressly provide otherwise, and it is usually required that this annual meeting be held in the principal office of the corporation.

At the annual meeting the directors for the ensuing year are elected, the reports of the officers are presented, any amendments to the by-laws may be submitted and acted upon, and any affairs of the company requiring the action or attention of the stockholders may be presented for consideration. If any sweeping change in the business or policy of the company is desirable, it is usually authorized by action of the stockholders at this meeting.

If action by the stockholders is necessary in the interim between the annual meetings, a special meeting may be called by resolution of the directors, or in any other way that the by-laws may prescribe or permit. This call is followed by a notice to the stockholders, giving the necessary details of the meeting which is to be held. In the case of a special meeting, both call and notice should state the purpose of the meeting.

§ 366. Quorum

The quorum at stockholders' meetings should be prescribed in the by-laws. The usual provision requires the presence of a majority of the outstanding stock in order to transact business. When a quorum is present, a majority of this quorum has power to decide any question that is brought before the meeting, unless it should be a special matter requiring a two-thirds or other larger vote to pass. Where it is not otherwise prescribed the common law rule is that those in attendance will constitute a quorum.

§ 367. Voting

Only stockholders of record are entitled to vote at annual and special meetings of the stockholders. Each stockholder of record is entitled to one vote for each share of stock held in his name. That is, if five directors are to be elected, the holder of one share may cast one vote for each of these. The holder of ten shares may cast ten for each and so on.

Under the cumulative system of voting, which is designed to secure for the minority a representation on the board, the holder of one share still casts one vote for each director to be elected, but he may cast all five votes—if five directors are to be elected—for any one candidate or may distribute them among the five as he sees fit.

Voting at elections of directors is usually by ballot.

§ 368. Voting Trusts

It is frequently necessary or important that the agreed management of a corporation be preserved consecutively for a term of years. This may be for the protection of minority or special interests or other valid reasons. In such a case a voting trust—sometimes called a “stock pool”—is the usual means by which this is secured.

This arrangement provides that sufficient stock to insure the desired end be placed in the hands of trustees for a certain period of time with definite instructions as to the way in which this stock shall be voted. A voting trust applies only to the stock of a single corporation, and must be distinguished from the attempts which were made to combine a number of corporations under one trust management. This latter system was used to form combinations in restraint of trade, and on that account has been prohibited.

New York and Maryland are the only states in the Union in which the voting trust is expressly sanctioned by statute, although in New Jersey, Massachusetts, California, Alabama,

and some other states the courts have rendered decisions favoring arrangements of this kind and intimating that where the trust was for a proper purpose and for a reasonable time, and did not contemplate any advantage from which other stockholders of the same corporation were excluded, it was not contrary to any principle of law or equity.

Any voting trust formed to promote a monopoly, or to dominate the corporation in the interests of another corporation, or to deprive other stockholders of their rightful powers, would undoubtedly be held illegal.

§ 369. Proxies

Any stockholder entitled to vote at a stockholders' meeting may usually give a proxy (a power of attorney) empowering some other party to attend stockholders' meetings as his representative and vote his stock in his stead. (See Chapter CII, Forms 31, 33.) In New York a proxy is good for any definite period not exceeding eleven months. In Pennsylvania a proxy is not good after two months. A proxy-holder need not be a shareholder. The inspectors of election have power to determine the genuineness of any proxy.

REVIEW QUESTIONS

1. What constitutes a man a stockholder? What rights have stockholders?
2. If a stockholder were denied access to the books what could he do? Could the holder of a single share enforce inspection of the books?
3. What is the managing authority of a corporation? What power has a stockholder? What power have the stockholders?
4. What right, if any, in your state, has a stockholder to demand a financial statement? Are stockholders in your state liable for wages of employees if the corporation becomes insolvent?

5. If a stockholder owned more than one-half of the stock, could he bind the corporation by a contract?
6. What are the liabilities of a stockholder? What is the liability of a stockholder in a national bank?
7. Where should the annual stockholders' meeting be held? What is the usual rule as to quorum?
8. Explain the operation and advantage of cumulative voting?
9. What is a voting trust? What can voting trusts do legally?
10. Must a proxy-holder be a stockholder?
11. When does a proxy which does not specify period, become in your state invalid?
12. Who has authority to determine the genuineness of proxies?

CHAPTER LIV

DIRECTORS AND OFFICERS¹

§ 370. Status and Functions of Directors

The board of directors, elected by the stockholders, has the entire management of the corporate affairs.

The directors of a corporation are held to be its agents, and, in a measure, trustees for the stockholders. They are responsible for its proper management.

§ 371. Number and Authority

In most of the states there must be at least three directors. The maximum number is not usually designated. For all ordinary corporations a small board is most convenient, and as a rule most effective.

When the board is unwieldy or difficult to assemble, the actual administration of the corporate affairs is usually delegated to an executive committee composed of from three to five members of the board.

The board elects the corporate officers, appoints such other agents as may be necessary, and has entire charge of the property, interests, business, and transactions of the company. The board of directors is the embodied corporate authority.

The directors can only act collectively and in a regular meeting or in a duly assembled special meeting. A single director, unless authorized thereto by resolution of the board, or specially empowered in some other way, has no standing in corporate matters above that of any other stockholder.

¹For forms of calls, notices, minutes, etc., of directors' meetings, see Chapter CVII, Forms 58, 60, 62, 65.

§ 372. Liabilities

Directors are liable in the same manner as trustees for any wrongdoing; also for any neglect that results in loss to the corporation. For instance, they are liable if they issue stock as full-paid which is not full-paid, or pay dividends out of the capital of the company when there are no profits, or otherwise abuse their power.

Contracts between directors and the corporation are generally held by the courts to be voidable but are presumptively valid. They may be voided by the corporation if any element of unfairness is involved. Contracts of this kind will always however, be more carefully scrutinized than ordinary contracts, and their validity may rest on the circumstances under which the contract was made.

In a case of a threatened breach of trust by the directors or officers of a corporation, an injunction may be asked by a stockholder or stockholders to prevent this and the stockholder's rights in this respect are not affected by the amount of his holdings. The same action may be taken by a director to remedy the breaches of his codirectors.

Creditors are not usually given any rights to interfere in the management of a corporation until they have obtained judgment and had an execution returned unsatisfied.

"The creditors of a corporation have no right, either at law or equity, merely because they are creditors, to interfere in the management, or to go into a court of equity to restrain it from making contracts or disposing of property, unless there is fraud or breach of trust to give the court of equity jurisdiction."²

A corporation where it is being pressed for payment of debts may make an assignment for the benefit of creditors.

² *Wither v. Lynde*, 49 Ga. 290; 19 Am. Rep. 645. *Thomas v. Sweet*, 37 Kan. 183. *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. L. 55. *Tompkins, Summary of Law of Private Corporations*.

§373. Qualifications

Most of the states require that directors shall be stockholders of the company; also, usually, that one member of the board shall be a resident of the state of incorporation. In some of the states the stockholding requirement may be waived by provision in the charter or by-laws.

§ 374. Vacancies and Removal of Directors

A board of directors may continue to act though there be vacancies, provided sufficient members remain and are present to make up a quorum. Vacancies should, however, be filled as they occur, and authority to do this should be conferred on the board by the by-laws. The board does not possess this power unless it is specifically given.

Directors cannot be removed, either by the other directors or by the stockholders, unless such power of removal is expressly given by the certificate of incorporation, the by-laws, or the statutes of the state.

§ 375. Regular Meetings

The times and places for regular meetings of the directors are fixed by the by-laws. Monthly meetings are generally prescribed. In a small company one regular meeting a year may suffice. Should action of the board prove necessary in the interim, special meetings may be readily called, or be held by consent whenever the occasion arises.

§ 376. Special Meetings

The by-laws should clearly prescribe the method by which special meetings of the board are to be called. Usually it is provided that the president or two or more of the directors may call such meetings. The call must be followed by a notice to each director. Calls for special meetings must specify the

time, the place, and the business to be transacted, these details must be repeated in the notice, and no other business than that so specified may be transacted at that meeting.

§ 377. Quorum

A majority of the whole board is usually necessary to constitute a quorum. A majority of the prescribed quorum decides the action of the board. Unless regulated by statute, the charter or by-laws may prescribe the number necessary to form a quorum.

Directors cannot give proxies authorizing others to represent them and vote for them at directors' meetings. The directors occupy a position of trust and they cannot as individuals delegate to others the trust vested in them.

§ 378. Officers

The board can act only through the officers and agents which it appoints. Usually the election of officers is held at the first board meeting in each year after the election of the new directors. In this way the new directors may elect their own officers and thereby secure an official staff in harmony with their views and policy. The usual executive officers of a corporation are a president, vice-president, treasurer, and secretary. Two offices may be held by the same person if the duties are not incompatible and if the by-laws permit.

The president and vice-president, as presiding officers of the board, should be chosen from its membership.

If a chairman of the board exists, that official presides at all meetings of the board. In this case the general rule that the president must be a member of the board is not so imperative. If, however, the president is to be the chief executive of the company, he must almost of necessity be present at meetings of the directors, participate in their discussions and deliberations, and should therefore be a member of the

board. Save as to these, the officers need not be selected from the board.

The officers of the company carry out the instructions of the board, and have no independent powers or authority outside the routine duties assigned them by the by-laws or by the statutes.

§ 379. Salaries

Unless it is specified that officers are to receive salaries, they are not, as a rule, entitled to charge for their official services. Neither is it ordinarily legal for the directors to vote compensation for such official services after they are performed. To avoid misunderstanding, however, the conditions, whatever they may be, should be clearly stated in the by-laws—that the officers of the corporation shall receive no salaries, or that the officers shall receive only such compensation for their services as the board may designate at the time of their appointment, or that the officers shall receive the salaries specified in the by-laws. The whole matter is one to be adjusted from a business standpoint, and much trouble is likely to be saved by a definite arrangement.

If, however, an officer is neither stockholder nor director of the company and stands in no relation which would make it to his interest to serve without compensation, there will be a *prima facie* obligation to pay him.

Officers who are also directors cannot vote salaries to themselves even though they are also holders of a majority of the stock. But an officer who is also a stockholder and a director may recover for services rendered outside his official duties if such services are authorized by the directors.

§ 380. Vacancies and Removal of Officers

The directors have power to fill, for the unexpired term, any vacancies that may occur among the officials of the cor-

poration. Officers cannot be removed at the pleasure of the board, unless the by-laws, charter, or statute law give the directors this power.

§ 381. Dividends

The matter of declaring dividends, the time when they are to be declared, and the amount rest in the discretion of the board of directors. When a dividend is once publicly declared, it cannot be rescinded. If the resolution is adopted but is not known, the declaration of the dividend can be nullified.

Dividends may be legally declared only from surplus or net profits. If paid from the capital or obtained in any way that will impair the capital of the company, the directors render themselves personally liable, and should the corporation become insolvent the amounts so paid may be recovered from the directors or stockholders for the benefit of creditors. The general rule in this country is that before dividends can be properly declared, any impairment of capital through business losses in previous years or through depreciation must be first made good. In other words, dividends must be declared out of "surplus."

Dividends are paid only to stockholders of record and must be equal as between holders of the same class of stock. Particular stockholders may not be favored either in time or in amount of payment.

§ 382. Bank Deposits

The moneys of a corporation should be deposited, in the name of the corporation, in some bank or trust company designated by the board of directors. Moneys so deposited should be drawn out only by checks, signed by the treasurer and countersigned by the president or by such other officers as may be properly authorized thereto.

§ 383. Execution of Contracts

Corporate contracts must be authorized by resolution of the board of directors. In practice, however, this rule is somewhat relaxed. The officers customarily make contracts in minor matters incident to their official duties without express authorization. If the officers have been habitually permitted to contract for the corporation without specific authorization, such contracts, unless obviously in excess of the proper official powers, are binding on the corporation.

§ 384. Corporate Seal

The corporate seal is either provided for in the by-laws and is therefore adopted with the by-laws, or is adopted by resolution of the board of directors. It should bear the name of the company, the state of incorporation, and the year in which the incorporation was effected.

REVIEW QUESTIONS

1. Who is responsible for the management of a corporation?
2. What is the object of having an executive committee? What authority has an executive committee?
3. What are the general powers of a board of directors?
4. Who is responsible if dividends are paid illegally?
5. May a person accept a present of shares in a company in consideration of his joining the board of directors?
6. State generally who is entitled to file a bill to compel the officers and directors of a corporation to account for any breach of duty or breach of trust.
7. A company's earnings for a year would enable it to declare a dividend of 10 per cent. The directors refuse to declare a dividend, deeming it better to use the profits in extending the business. Have shareholders who want the dividend any remedy at law?
8. Is a director or a stockholder chargeable with knowledge of a corporation's business merely because he is a director or a stockholder?

9. Are the executive officers of a corporation entitled to salaries?
How can officers secure salaries?
 10. Can directors give proxies for directors' meetings?
 11. Has the treasurer of a corporation, as such officer, any authority to bind the corporation by a contract for work, labor and services? Explain.
 12. From what source should dividends be paid? May a dividend be legally declared if former losses have impaired the capital of the company?
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